UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF VIRGINIA

IN RE:	.	Case No. 08-35653 (KRH)
	.	
CIRCUIT CITY STORES, INC., et al.,	.	
	.	
	.	701 East Broad Street
	.	Richmond, VA 23219
Debtors.	.	
	.	November 12, 2009
. . . . .	.	10:02 a.m.

TRANSCRIPT OF HEARING
BEFORE HONORABLE KEVIN R. HUENNEKENS
UNITED STATES BANKRUPTCY COURT JUDGE

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COURT CLERK: In the matter of Circuit City Stores, Inc., hearing on items 1 through 7 is set out on debtors' agenda.

MR. FOLEY: Good morning, You Honor. Doug Foley with McGuireWoods on behalf of the debtors.

THE COURT: Good morning, Mr. Foley.

MR. FOLEY: With me today in court from our firm is Sarah Boehm. As well at counsel table is Gregg Galardi and Ian Fredericks from Skadden Arps. Today here from the company, Your Honor, is Jim Marcum, the CEO, Michelle Mosier, the principal financial officer, and Debra Miller who is the general counsel.

Your Honor, the agenda only has seven items on it today. But as Your Honor is aware, it's been heavily briefed by a lot of parties and there's a lot of important issues to be addressed. We wanted to thank the Court for scheduling the hearing on these matters for today.

The way we would propose to proceed, Your Honor, is to deal with items 1 and 2 on the agenda which are motions filed by Hewlett-Packard first and then also report to the Court about a settlement that we reached with Hewlett-Packard last night resolving all of their claims in the case. They are the largest creditor in the case so we're pleased to be able to report that to the Court.

And then with respect to items number 3 through 7 on

the agenda, omnibus number 48, 49 and 50 deal with our motions relating to the application of setoff of receivables to various claims. And then items number 6 and 7, omnibus 51 and 52, deal with the applicability of Section 502(d) to 503(b)(9) claims. The way we would propose to proceed with those items, Your Honor, unless Your Honor disagreed, was to deal with the common procedural objections to going forward with respect to those objections first. And then depending on how Your Honor came out with respect to that, deal with the substance of the issues on items number 3, 4 and 5 and then move on to items number 6 and 7.

THE COURT: All right, Mr. Foley, that sounds reasonable.

MR. FOLEY: Your Honor, item number 1 is Hewlett-Packard's motion for an expedited hearing with respect to item number 2 which is their motion to seal certain documents. We have no objection to either of those motions. Mr. Terry is here for Hewlett-Packard.

THE COURT: All right, Mr. Terry?

MR. TERRY: Good morning, Your Honor. Roy Terry of DurretteBradshaw appearing as local counsel for Hewlett-Packard and that is the agreement, Your Honor. We would appreciate the Court filing that. We're accepting that document under seal.

THE COURT: Does any party wish to be heard in connection with the motions of Hewlett-Packard? All right, the

Court will grant the motions.

MR. TERRY: Thank you, Your Honor.

MR. FOLEY: Your Honor, while we are on Hewlett-Packard, omnibus objection number 49 which is number 4 on the agenda, Mr. Galardi and Mr. Terry can address the terms of the settlement that we filed about a half hour ago. Thank you, Your Honor.

THE COURT: All right, thank you.

MR. GALARDI: Good morning, Your Honor, for the record, Gregg Galardi of Skadden Arps. Your Honor, for the last four or five days we have been negotiating a settlement with Hewlett-Packard with respect to our setoff motion and our objection to their claim which is in the 49th omnibus objection.

Your Honor, the settlement that we filed this morning I'll be very brief about. We had agreed with Hewlett-Packard that they had essentially three claims and we'll be talking a lot about the three periods today. First was there was an administrative claim of $150,000. Second, there was a 503(b)(9) claim in the amount of $33 million. And then there was an unsecured claim in the amount of $92 million.

Your Honor, there was back and forth reconciliations but these --

THE COURT: Mr. Galardi, let me ask you.

MR. GALARDI: Sure.

THE COURT: When I was reading the papers I was unclear, was the 33 included in the 92 --

MR. GALARDI: It was not.

THE COURT: -- or was the 92 in addition?

MR. GALARDI: It was in addition to it, Your Honor.

THE COURT: All right, thank you.

MR. GALARDI: So we had gone back and forth. And the 92 reflected a compromise between us at 86 and them at 94 I think the number was or 88 and 94. Your Honor, then we also did a reconciliation with HP with respect to what we've called the receivables which included both pre petition and post petition receivables. And again, those receivables, back and forth conversations were spread over what I'll call the same three periods, the pre petition, the 503(b)(9) period and the post petition period and we came up with a number of $54,600,000 that was owed to Circuit City.

After much back and forth discussions, we came up with the following settlement. The settlement is the administrative claim which was $150,000, it was probably just a rounding error, to call that zero. There will be nothing on account of the pure 503(b) post petition administrative claim.

The Hewlett-Packard 503(b)(9) claim is going to be reduced from the $33 million to $6 million. So we got a lot of credit out of our $54 million receivable, to reduce that claim roughly by $27 million.

And then next, Your Honor, the unsecured claim which was 92 would be reduced and allowed in the amount of $64.5 million. So we essentially agreed to allocations of our receivables across administrative and non-administrative claims and come to that settlement.

Otherwise, there are releases with respect to avoidance actions with a carve out for both parties on there is this multi-district litigation pending about flat panels and they're not involved. We're involved tangentially but we left that open so that each party could still assert claims and defenses with respect to that.

And that is our settlement which we believe resolves the 49th omnibus objection. What we would do is provide ten days' notice for people to object to that and then proceed absent objections that that would be settlement. So in essence, while that is pending, our objection, on the 49th objection, is adjourned until this order becomes actually an order approved subject to our settlement. But that is the settlement with respect to Hewlett-Packard, Your Honor.

THE COURT: All right, thank you, Mr. Galardi. Do you wish to be heard, Mr. Terry?

MR. TERRY: Good morning again, Your Honor. Roy Terry as local counsel for HP. I would concur with the terms as have been recited by Mr. Galardi and I appreciate him doing so. I would add only that HP reserves all of its rights in the

event that the stipulation should not be approved. But if it is approved, then that will resolve all matters as to HP, yes.

THE COURT: Of course, yes, all right.

MR. TERRY: Thank you, Your Honor.

MR. GALARDI: And, Your Honor, one fact that I left out. Hewlett-Packard is the chair -- one of the committee members. The Committee has also agreed and supports this. We were in contact with the Committee. The Committee has agreed to this settlement. Hewlett-Packard obviously was not involved in the deliberations of the Committee with respect to its own settlement but we have been in contact and the Committee also has -- supports that settlement. I don't know if counsel for the Committee has heard that from their own counsel.

UNIDENTIFIED ATTORNEY: Your Honor --

MS. BERAN: For the record, Paula Beran of the law firm of Tavenner and Beran and on the line as well is Mr. Jeff Pomerantz from the Pachulski firm and he can speak more to it if Your Honor is so inclined. But yes, Mr. Galardi is correct, the Committee does support it and HP was not involved in any way, shape or form in the deliberations.

THE COURT: All right, thank you, Ms. Beran. Mr. Pomerantz has never been shy about speaking up so I assume he would if he's any different from --

MR. POMERANTZ: Ms. Beran is totally correct, Your Honor.

THE COURT: Thank you.

MR. GALARDI: Your Honor, that then goes to the next matters on the agenda and I guess, the omnibus objections 48, 49, 50, 51 and 52. There is, as Mr. Foley mentioned, there are a common thread of procedural objections which we could address first. I don't know if Your Honor wants me to address our response to those or whether you want to hear from the parties, those objections. However you'd like to proceed, I can respond to -- I think there are three common objections but whatever Your Honor -- however Your Honor wants to proceed, I think it's best to take those up.

THE COURT: Why don't you just sort of lay the table and then we'll let everybody else voice their objections?

MR. GALARDI: Sure. Your Honor, I guess -- as I read them, they come down to, I think, three objections. First is that somehow by going to threshold legal issues, we're depriving the claimants of their due process rights. Second is, and whether this is a Constitutional objection or something else, the second is we are seeking an advisory opinion in accordance with hypothetical facts that it would be inappropriate, as this Court knows, to do that. It's an Article III Constitutional issue in my view.

And then finally, the last objection is even if it's not due process and even if it's not an adversary -- even if it's not an advisory opinion, because of the type of relief

we're asking for should be brought in an adversary proceeding, we should have proceeded under 7001, filed the complaint and that argument goes to (1) we're seeking declaratory relief, and (2) that may be combined with or separate from, I can't quite tell sometimes, that we are seeking to recover money or other property under 7001 I believe it is. And therefore, because we're seeking that, we needed to go through an adversary proceeding. That's how I understand the three objections and I can respond to them and we can proceed however.

THE COURT: I think you can save your response until after the objections have been made.

MR. GALARDI: Thank you.

THE COURT: Thank you, Mr. Galardi. All right, does anybody wish to proceed with the objection to -- on the procedural matters?

MR. JOHNSON: Good morning, Your Honor.

THE COURT: Good morning.

MR. JOHNSON: Russell Johnson here on behalf of Averatec/Trigem USA. Your Honor, with respect to the advisory opinion issue, the debtors -- it's interesting on Page 3 of their omnibus reply they state how they want this matter to be bifurcated. They want the Court to issue a ruling on common legal issues and reserve factual issues for a later date, "Then..." and I quote, "...only after subsequent hearing would the Court enter an order sustaining overruling objections." So

we're not going to have any ruling by this Court under their proposed procedure, that could be appealed or addressed to the next level until after the factual determination. So why make that determination at this time?

Your Honor, what they're asking this Court to do -- there's no facts. We don't know what the facts are, at least as far as my client. They've said we have this claim. We've asked them for documentation regarding that claim because it's never been asserted before. So what is the Court's ruling going to be as far as that claim as opposed to every other person's claim? Are we going to have --

THE COURT: Then I have to accept the facts as you've alleged them for purposes of going forward today.

MR. JOHNSON: The facts as we have alleged them?

THE COURT: As you've alleged them.

MR. JOHNSON: Well, we filed a claim. We filed a 503(b)(9) and an unsecured claim. There's two claims out there. The 503(b)(9) is three hundred and twenty some thousand and the unsecured claim is -- was $600,000. It's been reduced down to about four hundred something at this point. And they've alleged that they have about a $200,000 offset claim.

And, Your Honor, I guess where we come with this is that there's so many different factual scenarios that are being presented to this Court today. Is the Court just going to rule on each particular one and issue multiple rulings on just on

the legal issues and then what happens after that? So we're stuck with a legal ruling based on hypothetical facts because we don't know if they have a claim. They've never asserted it before so it is hypothetical. They've asserted it in their pleadings for the first time with no supporting documentation, no chance for discovery, no chance to ferret this out to whether it isn't even a claim at all.

So you're essentially ruling, if they don't have a claim -- let's just assume for the moment they don't have a claim. They've never asserted it to this point. There's no documentation ever provided to my client. They don't have a claim.

You go and issue a ruling today that they can offset that against either the unsecured claim, which I think makes sense, they can probably assert that against the unsecured claim if they do, or can they assert it, as a setoff to the 503(b)(9) claim? Well, if they eventually don't have a claim, what have you done today? You've issued a ruling on a set of facts that doesn't really exist because they don't have a claim.

Your Honor, the other part about this is that, as I --

THE COURT: Well, the other side of that though is why should we go through all of the discovery and such to get to whether or not they have a claim if they're not going to

have a right to set it off?

MR. JOHNSON: Well, the issue is --

THE COURT: Isn't that the question I'm being asked today, do they have the right to set off? And if they do, you know, which claim can they set off --

MR. JOHNSON: I don't think it's disputed that they have a right of setoff. It's where they can apply it if they have a claim and that's one of the legal issues. But the case law on this and the various factual scenarios -- you could have issue 5, 6, 7, 10 different rulings today to deal with a creditor such as mine that has an unsecured claim and a 503(b)(9) claim.

Well, then what if you have a creditor that just has an administrative claim but no unsecured claim, is the ruling going to be different? The case law sort of indicates that there might be a difference for that.

What if they have -- what if their claim is a post petition claim and the other claim is a combination of various other things? There's numerous factual scenarios that they're asking you to rule upon without any facts, without any facts before you. And I don't know how it benefits the parties for you to rule -- there's a claim objection to the third one, to my client's -- they filed a claim and now they're dealing with a third objection. One is still pending and one was taken care of. So this is the third objection to the 503(b)(9) claim. At

some point judicial economy needs to step up and say Judge, can we just resolve all the issues of my claim in one proceeding? Why do I have to keep coming here for various hearings on various different objections to my claim? But that's another issue.

But if you rule today, what is the effect of that ruling? Is there going to be an order saying that they can do X or Y? Well, how does that affect our litigation when we don't know what the facts are, right? And so we can't -- is any party going to be able to appeal that? What if you rule in my favor and they're upset with that ruling, are they going to be able to appeal it? What if you rule in their favor and I'm upset with it, can I appeal that ruling? Are we talking about a final decision here that's going to be something that the parties can take up?

THE COURT: Well, how would any ruling I make today be any different than if I was to treat this as a motion for partial summary judgment?

MR. JOHNSON: Well, to get to partial summary judgment, don't you have to have undisputed facts?

UNIDENTIFIED SPEAKER: All right, I'm on a conference call, so when I take another call --

THE COURT: I'm sorry, whoever is on the phone, would you please put your phone on mute? Thank you.

MR. JOHNSON: The difference, Your Honor, as far as

the partial summary judgment question is you only get to partial summary judgment when you have undisputed facts. And here, we do have disputed facts. We have no idea what this claim is and they've objected to our claim. So it is different. It is different because when you do a partial summary judgment, there's undisputed facts, there's legal and factual issues that could be subject to an appeal. You've got legal and factual issues.

Here, we've got factual disputes. There's no issue here. So there are factual issues. We dispute their claim. They dispute ours. So what benefit does that give the parties? The parties -- if you issue a ruling that neither party can appeal, then they have to deal with this issue while they go through discovery. And then after all discovery is done and if they have to litigate the matter, then you issue finally this final order that they're talking about resolving their claim objection. Then, whenever that is, then that goes up if one party is not satisfied with the ruling.

So it seems to me it doesn't really benefit the parties to actually make this ruling today because we don't know what the facts are. It just -- that's what advisory opinions are supposed to be -- to prevent. The Court is not supposed to issue a ruling that is not a final ruling on a factual, legal issue. I say the Court doesn't have the jurisdiction to do it. There's just no facts before this Court

to do that and I don't see how it benefits the parties. Plus --

THE COURT: Doesn't the Court issue interlocutory orders all the time?

MR. JOHNSON: On various issues, yes, but I mean is this an interlocutory ruling here where the facts haven't even been established yet? I mean these are allegations. That's all we're here on. This is not summary judgment.

THE COURT: How would you propose to resolve these issues?

MR. JOHNSON: Your Honor, my client, I think, all these claim objections filed by my client, we should all have one hearing, not one proceeding to deal with that so my client doesn't have to deal with all that. But claim objections --

THE COURT: So you would have each client have their one day in court to argue this issue?

MR. JOHNSON: Well --

THE COURT: Because if I decided it in a case that you weren't involved in, then maybe you wouldn't have the right to be able to argue the issues.

MR. JOHNSON: That decision obviously wouldn't be binding on my client. Then we would be aware that the other decision is out there. Claim objections get settled 99 percent of the time. They don't come to this court. And they're coming to court today because they want some ruling that's

going to guide advisory only how they're going to deal with those fact scenarios, although I still don't know how the Court can issue one ruling here today with all the various fact scenarios that can present itself to the Court.

And that is troubling because if you issue -- what if the facts change? What if the facts that they have alleged against my client have changed and I'm not arguing the issue today that you rule on all these other separate rulings? Let's say the facts dramatically change as far as my client's concerned and now you've made a ruling today that after discovery, all of a sudden, those facts are relevant to my client?

THE COURT: Okay, what facts are going to change? I mean we know that you filed a proof of claim and you're asserting a claim against Circuit City.

MR. JOHNSON: Two claims, right.

THE COURT: We know that, okay. Circuit City is also asserting a claim against your client. We don't know whether it's valid. We don't know whether your claim is valid. You know, but we've got those two allegations. Now, what other allegations do we need to have from a factual standpoint that might change that would affect anything we do today?

MR. JOHNSON: As far as my client?

THE COURT: Yes.

MR. JOHNSON: I guess if they don't have a claim,

then any ruling you make is moot anyway because they don't have a claim.

THE COURT: And if you don't have a claim, then any ruling would also be moot?

MR. JOHNSON: Be moot.

THE COURT: So if I accept that both, for purposes of today, that both parties have claims without deciding what the claims or whether they're valid, just assume for purposes of today's ruling that you have a valid claim, they have a valid claim in some amount --

MR. JOHNSON: Right.

THE COURT: -- then how has that harmed your client?

MR. JOHNSON: I don't think it affects my client simply because they have just a 503(b)(9) and an unsecured claim. I think it could affect somebody that has just a post petition claim and a 503(b)(9) claim, but I don't see how it would affect my client specifically on that issue.

Though, as I said, I just don't see how you can issue one ruling, as a first matter, on all the facts that are being presented to you which could affect others. It's obviously not going to affect mine. Two, any ruling you issue today I don't think either side can take up on appeal. They're going to have to live with that ruling until the factual issues are decided. So I don't see what is gained by doing this because any ruling that you would do in a separate proceeding wouldn't be binding

on my client. And certainly, yes, if you ruled, you're going to be predisposed to rule that way, but maybe I can change your mind and my -- contest the matter at an adversary proceeding, however it comes up.

So I just think this is improper. I think we -- claim objections resolve themselves. We don't need these procedures. They get them adopted in this case, they're going to do just like they did in their brief, look, the judge did it in this case, and they don't even have any authority that even supports it. The two cases they cite in the reply brief, the Leeds and I'm trying to remember the other case they cited, Plastech, the parties consented to the procedure. They actually consented to it. They don't have any authority that anybody has actually done this without the authority of the parties and my client doesn't consent to these procedures.

THE COURT: All right, anything further?

MR. JOHNSON: No, Your Honor.

THE COURT: Thank you, Mr. Johnson.

MR. ENGLANDER: Good morning, Your Honor.

THE COURT: Good morning.

MR. ENGLANDER: Brad Englander. I'm representing Source Interlink Distribution LLC which is -- at the outset of this case was known as Alliance Entertainment and also an affiliate of that entity, Source Interlink Media LLC. And our view is a little bit different on this. We think that the

debtors -- there is an interest in having a ruling on common issues in a common way. That concept does not trouble me.

The problem is the procedures here today. The Court at the outset of this case entered an order governing omnibus claims objection procedures and that order expanded very, very broadly the types of matters that could be brought before the Court in an omnibus. Under Rule 3000(7)(d) there's a list of specified omnibus objection matters that the Court can entertain. The Court has the power to expand what it can do in an omnibus and the Court here did. And we've all been operating under that rule from the beginning of the case.

It's a very broad rule, but the one thing that the Court did that really gave the creditors comfort here is it included in the order a provision that said we'll go forward at the first hearing with respect to those who don't respond, but with respect to the creditors who respond, the first hearing will be a status conference and they don't even need to appear. And that sounds like a small procedural matter but it's not because what that permits us to do is to file a response and then work behind the scenes to develop a record, to develop procedures, to trade information as apparently happened between the debtor and the largest creditor in this case as the Court heard this morning.

Presently, my clients are subject to six separate omnibus objections and they have all proceeded in that manner.

All of those omnibus objections are procedural in nature, misclassification, filing claims against the wrong debtor, things like that. This one is very different.

And what we are here to ask the Court to do is not to vary from those procedures, to follow what's been done in this case. And there's good reason why we're here to do it. We invited ourselves to this party. We are not named in any of the three objections that we've appeared on. The ones we're appearing on are 48, 49 and 50. And I'd like to call the Court's attention that what the Court has to decide today is very different with respect to those omnibus objections than what the Court is being asked to decide with respect to the other two, the 502(d) objections.

48, 49 and 50 are what we call the setoff against 503(b)(9) and admin claims. Those are inherently factual. It is not simply a question of let's decide a legal issue and if you fit into that facts, then you go this way or that way. Each one of them really could be very different from the next. There may, however, be, as the facts develop, common buckets where we can develop through looking at the facts different categories of objections and relationships that might lend themselves to a global ruling on a subset basis, not across the board. But with no facts in front of the Court, you can't decide whether that's appropriate or not.

You asked before what sort of things could vary.

This isn't simply a question do we have a claim, do they have a claim. My client has a very complex relationship with the debtor. I'm talking now about the Alliance relationship, not the Simm relationship. The Alliance relationship -- Alliance, the Court may recall or may not, that was here at the first day and briefly described it, we handled shipping, the DVDs and CDs to the debtor.

We did two things. We sold product to the debtor, and this is part of what we did, sold our own product to the debtor and supplied all the stores. And we also handled servicing of products sold directly by major DVDs primarily. And so that was sort of a service-oriented process.

And there was a very complex relationship defined in a very detailed contract where there were products sold, returns, procedures for returns, procedures for crediting returns. Those were different than the returns, you know, the returns that came to us of our product were different than the return procedures when we were processing returns that went back to the major distributors. It's a unique relationship and it's not simply that the debtor may have a claim. These are credits under a single contract, an integrated transaction here and it's going to be very --

THE COURT: So you're arguing the recoupment issue?

MR. ENGLANDER: It may be recoupment. It may be recoupment. It may be simply that it's simply a reduction.

It's a method for calculating what the debtor owes to us.

THE COURT: Okay, and without getting into, you know, all of that, let's get back on the procedural --

MR. ENGLANDER: Right.

THE COURT: -- why we shouldn't proceed today.

MR. ENGLANDER: Well, first, the debtor hasn't identified -- the debtor is asking the Court for a global broad based ruling. It's going to affect everybody who has some sort of a credit or setoff. It's very vague what exactly the types of triggers are that would implicate this Court's ruling. The debtor is asking for that today. The debtor has not identified all of the parties who are going to be subject to this Court's ruling today.

The debtor did not name us but we know from dealing with this issue already on an informal basis that this is exactly an issue that we are facing and that the debtor will try to use this ruling to affect our rights. We noticed it. We have a relatively large claim, as I see it, for a million-dollar 503(b)(9) claim. It's significant. How many haven't noticed it?

Again, one of the essences --

THE COURT: Well, let's go back to the question I asked Mr. Johnson when he was up here.

MR. ENGLANDER: Mm-mm.

THE COURT: If I was to proceed on Mr. Johnson's

claim first because he was advocating do it on a specific, you know, entity by entity basis instead of doing this in a global fashion and I ruled in his favor or I ruled against him in the debtor's favor, wouldn't that ruling in just his case impact just like you're saying this proceeding today may very well impact you?

MR. ENGLANDER: I don't think so because the facts are going to be so very different. I'm really not sure when the Court rules today what has been accomplished. And again, I'm leaving aside the 502(d) issues here. I think this is -- on these setoff issues I think you're going to find that there are various different types of relationships and you may find similarities among them but I think that they're very different.

So if the Court rules on one, that's not necessarily going to impact the others. But I'm not suggesting that we all go off on our own separate ways and litigate the same issue hundreds of times. I don't think that would be practical and I don't think that would be good use of the debtor's resources or the Court's.

What I do think should be done, though, is that we follow the same procedures that have been followed since the very beginning of this case with respect to claims objections and that we deal, like you would in any piece of litigation even if it's one to one, in working out a scheduling order,

trading facts, coming up with agreed facts so that the Court has something in front of it. And it may be that various creditors are of a certain nature.

I'll give you an example. If a creditor -- if the debtor has a setoff right and it's a true setoff right, and it exceeds an amount, the total amount of the claims asserted by the creditor, that's an enormously different fact pattern than if the debtor's setoff right would still leave a remaining claim. Then you're dealing with the allocation between 503(b)(9) and the general unsecured claim. The motivation for litigating those and how you go about approaching those would be very different.

THE COURT: But the debtor is not -- they were very careful to say in their memoranda that they're not seeking affirmative recovery. They're only seeking to setoff.

MR. ENGLANDER: Well, they may not be seeking affirmative recovery but the difference between how you would approach it in defending against the objection would be very different if you are trying to deal with an allocation issue as opposed to completely wiping out your claim. But the facts remain is that these are facts. I mean you have different contracts. They could be governed by different laws of different states. The debtor proceeded in its -- when it filed this objection assuming Virginia law would apply. Our contract says it's governed by New York law. We saw it from HP's

papers. They're governed by California law.

You need to get down to the differences here to make sure that they're not salient. And we're not dealing here -- unlike the 502(d) issue where we're dealing with one section of the Bankruptcy Code versus another. Here, what we're dealing with is two sections of the Bankruptcy Code, 553 and 558, which preserve state law rights and using those against a priority provision in the Bankruptcy Code. So you have to --

THE COURT: Isn't the law set off -- I mean is it different between New York and California?

MR. ENGLANDER: I'm not sure that these are going to be great differences. I think though that the parties need time to look into that and it could be relevant. Certainly we're already seeing different arguments on recoupment and how it should be construed. But these are issues that could be affected by the terms of the contracts, the course of dealings between the parties, the nature and timing of the returns.

And you're being asked to make a ruling -- take an example here. You're being asked to make this ruling as though it's a simple, broad base, across the board ruling without any facts in front of you. One fact that you may find, Your Honor may find to be very relevant as you look into the matter is when were these credits generated and how were they generated. Were they generated a year before the petition? Were they generated on the 21st day before the petition? Were they

generated during the 20-day period? Were they generated post petition? The debtor is asking you to, as a matter of law, treat them all as exactly the same. And the debtor can get away with that now only because there's nothing in front of Your Honor.

And this is -- this really is an important issue. It is a relatively novel issue. It's obviously only arisen as to the 503(b)(9) claims since BAPCPA and there's very little case law on it. And the cases that were decided -- what was critical, common theme, Courts needed to have the facts. Two of the opinions vacated the lower court opinion because more facts were needed or a more detailed factual finding was needed. That's on appeal.

So that says something here. It says we really need to know what the facts are. It doesn't mean that they're all going to be different. It doesn't mean you're not going to have commonality. And it doesn't mean you can't use the omnibus procedures to come up with a practical, cost-effective way of resolving claims. But what it does mean is that we have to go through the process just as we have with 47 prior claims objections to reach -- to accommodate the parties, to work out procedures, to make sure that a factual presentation is provided.

Even if you were to look at this as a partial summary judgment motion, the most basic rules -- I mean if you say --

and Rule 56 does apply in contested matters, right off the bat you have to look at Rule 56. It says you can't even file a Rule 56 motion for 20 days after you file your -- commence your action. Now, here it's filed with the original objection asking for relief against parties who aren't even named, essentially for just the reasons the Court raised. They're asking for a very broad base ruling and parties have not been named. And trying to bifurcate an issue where all authority for bifurcation that the debtor's relying on essentially says the parties agreed. This is a practical way to resolve the matter.

THE COURT: So what you're asking me for then is you say that this should be treated as a status conference pursuant to the Court's original order and that, you know, everybody should come back on another day and take up this issue and don't take it up today?

MR. ENGLANDER: That's exactly what I'm asking. Let the parties do what they've done very effectively so far and that is work out -- reconciling the facts, coming up with procedures, working on scheduling orders, things like that.

Your Honor, you're being asked to make a decision which is going to be widely reviewed. It's going to be focused on. It's an important issue, lots of policy concerns on it. I think that the Court would be well served to make a decision like this on an adequately-developed factual record. I don't

think that we have to go through a year of trial for every issue. But I think that the Court would be well served in that way.

I don't think the debtor will be harmed or the other creditors will be harmed in any way. There's been no showing of any sort of an exigency. And, in fact, what we saw this morning almost proves the opposite, that if the whole idea is to let's get something resolved so that we can get matters settled, what we just saw is the largest creditor in the case settle out before any resolution. So attorneys know how to resolve matters without having the Court tell them which way the Court is going to go. And I think that everybody would be well served by preserving exactly that dynamic.

So I would simply suggest that we go forward in the ordinary way, develop the factual record and then let the Court decide it as in let the parties present a proposed scheduling order in a way to manage this process. I would also suggest that the Court ought to require some level of certainty that all of the parties who are affected by this proposed ruling be before the Court. Like I say, I know we were brought before on this one. I don't know how many others are out there that are similarly situate. I think it's a matter of simple fairness and due process that if people's administrative priority claims are going to be at risk, that they be given notice of that fact.

THE COURT: All right.

MR. ENGLANDER: Thank you.

THE COURT: Thank you, sir. Yes, sir?

MR. CARRIGAN: Good morning, Your Honor. Daniel Carrigan from McKenna Long and Aldridge for Bethesda Softworks LLC. Our particular client has a very small unsecured claim of about $34,000. It also has a 503(b)(9) for what we'll, for purposes of the hearing, call a claim although it's an administrative expense of about $3.8 million round figures. The debtors, we are one of the creditors named in the 51st omnibus objection. Our claims have been the subject of two other omnibus objections and those omnibus objections have been resolved. They were essentially a duplication of multiple claims filed on the same -- for the same amounts.

The 51st objection does not make any reference to any setoff claim against our client except that there --

THE COURT: The 502(d) issue.

MR. CARRIGAN: Well, it is, Your Honor, but in discussions with the debtor, we are aware that they are asserting a setoff claim for both pre petition and post petition amounts due to the debtor. Our -- I guess -- I suppose it's a procedural question is this and it's raised in large part by the settlement that was announced this morning. What's the purpose of allowing or disallowing claims? Well, the first one is for voting on the plan. But for the -- for

all practical purposes, that's irrelevant for our client because we don't get to vote on the plan. We have a $3.8 million 503(b)(9) claim. We don't vote. The only thing we can do is object. So that's not the purpose of this exercise.

The second purpose is for allowance -- of allowance or disallowance is for distribution. Now, the question that was unanswered by the description of the settlement this morning is when is the allowed amount of that claim, the $6 million 503(b)(9) claim going to get paid? Under the plan as it's currently proposed, it's our understanding that the initial distribution date is going to be five days or thereabouts after the effective date of the plan which means in theory, given the schedule we have, that claim could get paid before the end of the year in cash in full.

But what's proposed in these motions, and that's an interesting question. Should any of these claims be paid until everybody's get paid? But that's a question for the plan in the next couple of weeks down the road.

But then the question becomes is what is it that the debtor is, or actually it's the estate I suppose, it's not really the debtor, this is the estate, and the estate is setting up for a liquidating trust, what is it that seeks to be accomplished by temporarily disallowing the difference between what they call the preference or the preferential amount and the 503(b)(9) claim?

If -- and that really -- and what happens to the rest of it? In our case, for example, it's 3.8 million is the 503(b)(9). Let's say we, for purposes of argument, we deduct the 100,000 bucks and that's temporarily disallowed, whatever that means. And then the $3.7 million is left. Is that allowed? Is it not allowed? Is it disallowed? Is it in the first initial payment date? Do we have to wait the 120 days after the effective date to find out whether or not it's allowed or disallowed or is going to be challenged or whatever? Does the temporary disallowance last to the end of the 90-day period within which we have to be advised whether 502(d) is going to be applied to our claim to hold up any distribution or not? What's the purpose of doing this?

And what happens to that piece of the claim that's not temporarily disallowed? And that's really the fundamental question here is how fast this has to be done and all that really revolves around what's the purpose of this exercise. If the purpose of this exercise is to determine whether or not the plan is going to be feasible in that the estate has enough money on the confirmation date to pay all allowed 503(b)(9) and other 503(b) claims, then it is something that really needs to be decided before we get to the confirmation date.

If it's for purposes of distribution and no distribution is contemplated on account of 503(b)(9) or other administrative claims until some time after the initial

distribution date which at the earliest, if I understand it correctly, is going to be a periodic distribution date which is going to be after the 120 days of objection periods, we're down the road a piece.

But the question that's not been addressed in any of this as far as we can tell, although I believe in some of the responses the estate has suggested that what's going to happen is that as to the difference, the part that is not temporarily disallowed, that it's not going to be allowed or disallowed and so will come up on confirmation and I suppose they could argue they don't have to take it into account to determine whether or not 1129 is satisfied in terms of being able to paid allowed administrative expenses on the date of confirmation.

And that's our question, Judge, is why are we doing this? And what is the significance of being temporarily disallowed? And what happens to the piece that is not temporarily disallowed? Thank you, Your Honor.

THE COURT: Thank you, sir. Any other party wish to be heard? Yes, sir?

MR. GOLDBERG: Good morning, Your Honor. Michael Goldberg on behalf of Samsung.

THE COURT: All right, Mr. Goldberg?

MR. GOLDBERG: Your Honor, I don't need to repeat what counsel has said because they eloquently stated the position which we adopt. I just want to make sure we've

already raised it in our papers and I want to make sure by not coming up here and going through the same exact repetitive argument that I'm not waiving anything for purposes of the record and that our objections to this procedure is preserved.

THE COURT: They are.

MR. GOLDBERG: Okay.

THE COURT: And then I've read your papers.

MR. GOLDBERG: Thank you, Your Honor.

THE COURT: Thank you.

MS. MORRISON: Good morning, Your Honor. I'm Valerie Morrison from Wiley Rein here on behalf of LG Electronics and Envision Peripherals, part of the 51st and 52nd omnibus objections. My question procedurally is what happens in part two of this proceeding? Today they're asking for the Court to make a decision on certain legal questions. But what is part two? Is that an adjudication of preference liability? The debtors have represented to the Court and in their papers that they're not seeking affirmative relief of any kind, that they're simply filing this as a defensive mechanism.

But in the case of my clients, the amounts of the alleged avoidance actions exceed the amounts of the 503(b)(9) claims which leaves me with the question are the debtors then not proceeding on the entire avoidance action? Are they simply proceeding on the amount for which they seek offset? Or is this part two an adjudication of their entire avoidance claim?

In which case if it is, Your Honor, then really what this is is an adversary proceeding because eventually, they are going to want to recover that avoidance action unless, of course, they're waiving it which I don't think they are.

THE COURT: Well, they would have to file that as an adversary proceeding if they want to pursue their remedies under Section 547, right?

MS. MORRISON: I think that they would have to file this whole thing as an adversary proceeding, Your Honor, because otherwise, my clients are subjected essentially to two pieces of preference litigation. Or are they going to simply adjudicate the entire preference matter in the context of the contested matter and then later seek by ministerial act eventually of an order to convert that into a judgment that's actually recoverable? If that's the process they're employing, Your Honor, then what they're really doing is using the contested matter process to effectuate an adversary proceeding which is impermissible under Rule 3000(7)(b).

THE COURT: All right, thank you.

MR. GRAY: Good morning, Your Honor, William Gray. I represent Metra Electronics Corporation and Tamrac Inc. I would just -- first of all, just to make sure, I'm not sure I heard it on the record but I do believe 502(d) requires an adjudication. It talks about when a transferee is liable.

My point, though --

THE COURT: We're going to get into all that later I think. We're talking about the procedural stuff now.

MR. GRAY: Well, I understand but I think that goes to the procedural part. And what I would add is more bringing back -- to bring us back to what is before the Court. We've talked about facts. Facts have to be established by evidence. What's before the Court? Basically pleadings. The debtor has asserted in their pleading.

I'm sorry, if I could back up. I'm on the 51st omnibus objection which is 502/503. So the premise of the objection in the 51st is that there's an avoidable preference, has to be. The debtor does say that they have to establish a prima facie case of that and they, I believe, allege that their allegations of it in the objection is that case, is the prima facie case.

Well, we have filed an opposition. Our opposition denies that there's an avoidable preference. So what's the Court left with as evidence? Well, their pleadings, our pleadings. Does that establish the fact of avoidable preference? I say it does not. And since the premise of their objection and the relief to temporarily disallow is the existence of an avoidable preference, there is no prima facie case of that at this point in the proceeding. So, therefore, it should be disallowed.

THE COURT: All right, thank you.

MR. GRAY: Thank you.

THE COURT: Mr. Starr?

MR. STARR: Your Honor, Leonard Starr representing Namsung America. We provided manufactured electronic parts to the debtor. During the 20-day period of time prior to the filing we have a 503(b)(9) claim for $204,364.26. The debtors have filed their 51st omnibus objection and have simply alleged that we have an avoidable preference in the amount of $93,174 which they seek to temporarily avoid.

I agree with the speakers before and incorporate all of their arguments and probably those that will follow me. The allegations are just that, simple allegations. There's no facts supporting that even though in their brief the debtor stated and I quote, "The debtors thoroughly reviewed and analyzed the transfers made to the claimants within 90 days of the petition date and for the two-year prior to." But there's no facts that are alleged. Even when I was in high school, my high school teacher wouldn't let me get away with that in math class. They said show me your work, show me your work. How can that be a prima facie case where there are no factual allegations? That is, I submit to Your Honor, that that is not a prima facie case.

The detrimental effect of allowing the debtor to do what they're trying to do has been touched on earlier and that is the ability to affect the distribution under the plan which

has not yet been confirmed but which is coming up for a hearing as I understand this month. If we are cut out because of this "temporary disallowance," it allows this motion to affect the distribution process required by Section 1129 and puts us at risk, as we said earlier, if there are any distributions made for administrative expenses unless there is adequate protection that these claims can be, in fact, paid. We would ask that the Court deny the motion of the debtors.

THE COURT: And how would you propose we proceed then to resolve these issues?

MR. STARR: I have no objection really to resolving the issues. What bothers me is coming to an order that prejudices a legal ruling on the legal aspects of it doesn't bother me. It's allowing, after getting to that point, the Court going to an order which does adversely affect the people that does bother me. So I would suggest to the Court that if it does rule on the legal issues, that it crafts some way to protect those people. Perhaps there's been one motion filed for an escrow to be created to pay administrative expenses, the ones that were temporarily disallowed.

THE COURT: All right, I understand your issue, thank you. Anybody else wish to be heard? Is there anyone on the phone that wishes to be heard? All right, Mr. Galardi, you may respond.

MR. GALARDI: Your Honor, first, I haven't heard --

well, I did hear, due process once but let me address that first. Obviously, everybody who received a claims objection has had notice and opportunity to be heard. Second, Your Honor, you've asked the question I think three times to three different people, well, isn't it the case that if we proceeded separately, this would affect your rights? And the answer is yes, law of the case.

And this is exactly, again, everybody here knows I was the Plastech attorney that came up with this, and the fact of the matter is everybody complained because I went after one, perhaps choosing the weakest link and they all objected saying oh no, that's not fair because then my legal rights will be affected. So the reason that we did it this way this time in the first instance is because we understand that everybody has a voice to be heard on the two legal issues.

And so it is law of the case. It's not a factual determination and we thought the best way to give everybody notice and opportunity to be heard on the legal issue. And I want to stress, this is only two legal issues I think today. On those legal issues is to bring in as many of the claimants as we possibly could. Now, I understand Alliance has complained that we've given them four objections. They're also in bankruptcy so we didn't add them and theirs is a more complicated situation but they're aware of the docket and the objection. They're not even involved in this 48 through 51 but

they're here as a friend of the Court -- or 52.

But the fact of the matter is we think we satisfied due process. Everybody knows. We've said this -- I think I even said it the first day of hearing that we would be doing these kind of procedures and it is also a procedure that Your Honor has already used when we did the 503(b)(9) to sort of come up with the threshold issues on what's the definition of goods. So we think it's not a due process issue.

Now, let's get to the adversary -- the advisory opinion. Is there a justiciable issue? There is absolutely a justiciable issue before Your Honor on both of these motions. We've said we've had a receivable. I'm going to go through the pleadings rules because people don't seem to go back to Federal Rules of Civil Procedure and throw out -- they don't know facts. But there is, in fact, a justiciable issue.

First, Your Honor, if we go back to what we've done, they have filed a claim. Let's ignore the fact that some of it is prepetition, unsecured claim for which it's prima facie valid. 503(b)(9) claims are not prima facie valid. They still have a burden. But we're going to assume they have those claims. And by the way, we're also going to assume they have 503(b) claims. We've assumed all the facts. Now, what do we have to do? Well, we are seeking an affirmative defense, not a counterclaim, not a cross claim.

And the rules of evidence -- I mean the Rules of

Civil Procedures say, in Rule 8 affirmative defenses, those things that we put at the end, failure to state a claim, laches, blah, blah, blah, you never plead the facts there. What it says is in general, when responding to a pleading, treat their claim, a party must affirmatively state any avoidance or affirmative defense and gives a list. You don't have to even plead facts when you assert an affirmative defense.

We went further in the 503(b). We pled facts. We said you had an avoidable transfer. They can dispute those. But if we had done it as a counterclaim, we would have gotten the same on a motion to dismiss our counterclaim. You would have to assume those facts are true. All we've done in this complaint or all we've done in this objection is you get your validity, we'll assume everything you say is true, we get our avoidance action, assume what we say is true and let's just deal with the legal issues. There's no genuine issue yet of material facts.

Yes, as you asked Mr. Johnson here, if it turns out we don't have the preference, this is going to be irrelevant to him. If it turns out he doesn't have a claim, our objection is irrelevant. He's asserted a claim, we've got an avoidance action and what do you do? You play it out. But, we have an avoidance action and you are entitled, without pleading all of the facts, to say whether this affirmative defense of setoff or

of a preference is sufficient to knock down or reduce your claim. And we've presented that legal issue.

There's a justiciable issue. Indeed, we took a narrow view on 503(b)(9). If we had one dollar, a 502(d), we could have argued the entire claim. We just tried to reduce it. We took it as a very simple affirmative defense because we don't think we're administratively insolvent. So, we think we've met the pleading requirements of an affirmative defense. We think we've gone beyond that and we'll talk about that when we come to 503(b)(9). But, on setoff, setoff is a traditional, affirmative defense. You make an allegation, you have it. You don't even in a pleading, if this was a complaint, have to go through the details. We did. We went through the details and said, and in fact we gave Mr. Johnson -- he may not like the adequacy of the information -- we gave Mr. Johnson our receivables.

So, we've taken a litigation position. Whether those receivables were prepetition, whether they were 503(b)(9) period or whether they're post-petition, our view is 558 says we can offset. Their view is, you've got to go first to the unsecured claim. The only issue Your Honor has to say is, okay, but which of those positions is right? How do we decide that issue? That's what we think we've presented in 51 -- in 48 and 49. And in 51 and 52 we've raised the same argument I raised in Plastech, it's the cover of the ABI Journal,

everybody says Ames says this, that and the other thing.

Okay, we've raised the issue in the Fourth Circuit. Your Honor's going to have to decide that issue. We're not going away. We think those cases are wrong. That's all there is to it, and we're entitled to do that. And that's a simple, legal issue. And it is an issue that affects everybody in this courtroom in some way, shape or form at this particular time without resolving the facts, because they've made allegations of claims, we've made allegations of avoidance actions or affirmative defenses. So, there's a justiciable issue. They know it, we know it and it has significance.

And as to the beginning of an adversary proceeding, the fact of the matter is, Your Honor, we are not seeking affirmative relief. We are not seeking to recover the money. We are not seeking to get back any sort of payment.

Now, the lady who came up says yes, there is one claimant that we might have preference actions that are greater than, but we are not by this action seeking that. And presumably when we get through this, they will say our preference analysis is flawed and it's far greater. But, let's get to the one issue, because I'm most concerned about one thing, as they've all pointed out, and we'll not argue confirmation today, what would we have to distribute on confirmation? You don't distribute undisputed claims. So, instead of waiting until this point, what I think the people

want us to do is, we'll just make the payments or set it aside and don't raise the objections. The only way to get to an actual distribution is to figure out what the claims are. This is an expedient way to get there. Otherwise, as you've asked everybody, well, what's the alternative? Okay, we would start probably thousands of adversary proceedings, seek a partial summary judgment with an affirmative defense. Say everything you say is true and I have this defense and we would never get to a distribution or a confirmation, and that's nice and you'll pay us legal fees to remain here for another year or two and the committee another year or two, but that's not the efficient way to run this case, not that efficiency overrides due process or adversary proceedings or advisory opinions. But, the fact of the matter is, we've not violated a single rule of civil procedure, of 3007 which allows us to raise the claims as a claim defense. It is a contested matter. There is a summary judgment aspect to this, a partial summary judgment. It is not unusual to issue interlocutory decisions. And we're not violating the justiciable Article 3 issue because there is a dispute on both of these motions, and 7001 is simply not implicated since we're not seeking affirmative relief.

So, we would ask to proceed on this method and head -- and move on to the legal arguments on the setoff and the 503(b)(9). Thank you.

THE COURT: All right, thank you, Mr. Galardi. All

right, the Court --

MR. CARRIGAN: Your Honor, may I be heard again in response to Mr. Galardi?

THE COURT: Very, very short, Mr. Carrigan.

MR. CARRIGAN: Thank you, Your Honor. I believe that counsel said that you don't distribute on undisputed claims. I believe that probably was a misstatement. He had in mind that you don't distribute on disputed claims. But, what's conspicuously absent from the debtors' or the estate's response is, what happens to the -- what's the purpose of the temporary disallowance? I think we get that. That's not going -- so that piece is not going to be eligible for distribution on the confirmation date, and it's not going to be included in the calculation for feasibility, I suppose. But, what about the rest of it? The conspicuously absence is, what about the rest of it? And conspicuously absent also was, what about the six million for the creditor that settled? Are they going to get paid on the confirmation date? Those two are still conspicuously absent.

Secondly, as the Court noted earlier in the context, as we walk through it, of the civil procedure, this is -- I believe you analogized it to the summary judgment process, in which you assume all the facts favorable to the opposing party. And, in fact, in this case, pursuant to the Court's order, our clients have filed affidavits in the form of the claim form for

503(b)(9)s and in the form of the claim forms under penalty of perjury for unsecured claims that establish our claims.

So, what we have is a summary judgment motion that's opposing ours without affidavits, without any testimony, without anything. And therefore the facts are conclusively, for purposes of the motion, established in our favor which I would respectfully suggest that the amounts and everything else of our claims are established for purposes of this motion and therefore are allowed.

THE COURT: All right, thank you, Mr. Carrigan.

MR. CARRIGAN: Thank you, Your Honor.

THE COURT: All right. The Court is going to allow the proceedings to go forward. The Court is satisfied that the due process concerns have been addressed. There has been notice and there has been obviously an opportunity for a hearing. We're going to have that hearing today, and the parties are here.

The due process, as the Fourth Circuit has pointed out, is a flexible concept and certainly by all means has been satisfied to the Court's satisfaction. The Court's also satisfied that there is a justiciable controversy before the Court concerning the affirmative defense that the debtor seeks to raise to the claims that have been filed, as well as the request for administrative expenses under 503(b)(9). And so the Court thinks that it is a simple legal issue that needs to

be resolved. Today there are two of them, and that the Court can resolve those, much like the Court did previously with regard to the question of goods versus services in the concept of 503(b)(9) in order to resolve the legal issues so that the factual issues in the rest of the case can go forward.

The Court's also satisfied that Rule 7001 is not implicated as the debtor is not seeking any affirmative relief. And, Ms. Morrison, you will not be subjected to any kind of a claim against your client, nor will anybody else affirmatively unless there's an adversary proceeding brought. But, this is done by way of affirmative defense which is just to -- by way of defense to claims and request for payment of administrative expenses and not by way of affirmative relief.

I think that it's important what Mr. Galardi said that he could have brought this against one person and gone forward, as done in Plastech. But, by doing it under this kind of procedure, it allows everyone's voice to be heard. It's more inclusive, and I think that that's a good thing rather than a bad thing. And so I'm going to bifurcate proceedings pursuant to the request of the debtor and allow these two issues to go forward here this morning. So, with that, Mr. Galardi, you may proceed.

MR. GALARDI: Thank you, Your Honor. I'll take up the legal issue, I guess raised by the 48th and 49th omnibus objection first, the setoff issue.

THE COURT: That's what I would like to do. And then we'll take up the 502(d) issue second.

MR. GALARDI: Your Honor, again, I think that all of the sort of legal principles for the most part, or I'm going to cite what I think the legal principles are that all parties agree to. One, we agree that 553 preserves a creditor's right to setoff as under state law. And nothing here -- if there are differences under state law, we're not trying to take those away from anybody. We will presume that various creditors in this room have rights to setoff under 553. I will also point out that I don't think they disagree that setoff is an equitable remedy that the Court does have some discretion whether to grant or not grant on any particular instance. You still have to make a motion, you still have to lift the stay -- which one person already has admitted that they did not do and exercise their setoff rights, so we'll come back to them at some point -- and that it is subject to the discretion to lift the stay and to exercise their rights of setoff, and that 553, we'll even admit under 506(a), gives them a secured claim to the extent of the setoff.

That does not answer the fundamental question is, what property secures that under 506(a)? It does not say whether you have to -- you get it to exercise it with respect to the most advantageous to you, i.e. the little unsecured claim, as I say, gets paid in little itty bitty bankruptcy

dollars, or whether you could be forced under a marshaling or an equitable standard to exercise that right with respect to other claims. That's the open issue, it seems to me, from the creditors' perspective. 558 on the other hand, and I don't think people -- well maybe they do disagree with those cases -- but 558 says the debtor has all the rights and does not waive those rights, and then we have cited cases that say 558, you are permitted to use prepetition receivables to offset post-petition. And I'm using petition date, because that seems to get confused in a number of things. I know it will become important when we get to 503(b).

For the purposes of this setoff argument, what we have sought to do is to say, we have receivables, just like we did with HP. We have prepetition receivables and we have post-petition receivables. But, from the debtors' perspective, our view, our legal proposition is, it really doesn't make a difference from our view because we should be able to set them off for the benefit of the estate. So, we'll go what I call top down.

The most valuable claims we would like to set off, starting with administrative or 503(b)(9), and only if we have a leftover do we want to go to unsecured. Not surprisingly, everybody in this room wants to go in exactly the opposite order. They want to say, let's take the receivables, let's do the prepetition unsecured, because I know I'm not going to get

more than 100 cents on the dollar. I'm taking it from unsecured. Then maybe you go to the 503(b)(9)s, but certainly don't let us go over the petition date hurdle and use them there.

Your Honor, there is no section of the Bankruptcy Code that addresses that. That's our point. The question to Your Honor is, who decides it? Creditors say they get to do it at will. They get to pick. That somehow we would violate 553 if we did it the way we're asking. We say the debtor -- as the debtor's obligation to maximize value to the estate and under 558 we should get to do it in the way that maximizes value to the estate, and if we have a receivable that we could force them to pay us 100 cent dollars, we should use it to offset what we would have to pay them, 100 cent dollars. That's the fundamental legal issue. And in that issue, one new section of the Bankruptcy Code has caused even more of a problem, because 553 talks about pre-bankruptcy claims. And 503(b), though people want to say it, and I don't know how it could be clearer on its face, it is entitled to administrative priority, but it is a prepetition claim. 503(b)(9) says, it must arise in the 20 days prior to bankruptcy.

So, our first argument is, if you have a prepetition receivable, we think you can bring it to the post-petition period. But, even if you can't, even if Your Honor wants to draw this big line here and say you can't get over that

petition date, the fact of the matter is, a 503(b)(9) claim, though it's an administrative expense, is a prepetition claim. And we think we could setoff our receivables against a 503(b)(9) claim. They say no, we say yes. We leave it to Your Honor to decide whether we can do that. We think the code does not require both prepetition, post-petition for the debtor. It does for them. But, even if it does for them, why should they get both the 503(b) -- you know, why should they get a receivable, a prepetition receivable to select the least valuable when, in fact, 503(b)(9) is a prepetition claim.

That's the simple legal issue. Our view is, Judge, you have the discretion to decide that. One, debtor thinks we can go all the way to 558 and go all the way. They say no, I can do it against my claim. And I think the Court, because it has total control over how to equitably allocate the receivables, if you so choose, can say we can go all the way to the post-petition or I don't want to draw that line, but it certainly can go to the 503(b)(9) and it's consistent with the policies of the Bankruptcy Code. Because if you think of it, and I said this last night to someone, think of -- if the bankruptcy could be done in one instant, what would you do? Will you get all of the cash back by way of preferences and everything else, and then you distribute it according to the priority scheme? What this is, is a concession of time. The setoff rules say, okay, I'm not going to bother, you're going

to take it back or in certain cases, I'm not going to take 100 cent dollars, because why would any creditor give me back 100 cent dollars only to get a penny? What we're saying is, you owe us the money, we can get it back. Offset from the debtor's perspective is a valuable right, because it's again a concession to the shortness of life. I don't want to have to sue you, go through the collection risk to bring the cash back in so then I could really satisfy the Bankruptcy Code priority scheme. That's all we're trying to do. We're trying to bring that cash in and use it to pay the claims that are highest in the priority first and actually go through the distribution schemes.

Congress has said that an unsecured creditor can use their setoff and not have to give back that money, and I understand that. That is what the code says. But, there's still an equitable issue, do you bring it all back? Again, if this case were administratively insolvent and where Plastech was worried about that, every creditor in here who had an administrative claim would be supporting what we're doing. Bring that money back, because you don't want an administratively insolvent case. They're just not worried about that in this case. But, the same principle applies, because only by bringing back those receivables and using them to pay the highest priority claim do you actually live to the spirit of the Bankruptcy Code. Priority claims, administrative

claims, all get paid before people get a distribution on the unsecured claim.

So, Your Honor, we would ask Your Honor to rule, one, that a receivable, whether it's prepetition or post-petition can be used to pay down or to offset against an administrative claim. And by administrative claim I mean a post-petition administrative claim. If you're not going to go that far and you see this, I call it the imaginary wall of the petition date, then there is simply no logical reason under 553 why it cannot be used to offset the 503(b)(9) claim, because it is a prepetition claim. It may get an exalted status, but it is still a prepetition claim. And what they're asking you to do is to equitably allow them to marshal their claims to the detriment of the estate and only let us use it on their prepetition, unsecured claims. That again is asking for equitable relief from the Court. And I'm not sure the basis for such equitable marshaling, in their instance, when it can prejudice other creditors, such as administrative creditors, such as 503(b)(9) creditors. We're doing what we think the Bankruptcy Code requires. Get all of the assets and make sure the highest priority claims get paid first. Thank you.

THE COURT: Thank you, Mr. Galardi. Does any party wish to be heard in connection with the debtor's motion? Mr. Epps?

MR. EPPS: Good morning, Your Honor. A.C. Epps Jr.,

on behalf of Digital Innovations. I am also authorized by Mr. Bliley, he represents South Peak and NYCO, to speak on his behalf, as well.

THE COURT: All right, thank you.

MR. EPPS: Your Honor, my remarks actually go to both issues. I think Mr. Galardi said he was speaking only to the setoff, but I think his remarks go to both issues, as well. So rather than burden the Court with speaking twice, if you would let me just speak once and I'll not speak to the other motion --

THE COURT: I would like to focus on the setoff issue before we get to 502(d), because I see those as very different issues.

MR. EPPS: Well, they certainly are different issues in the sense that they have different code provisions that govern. And I do agree to that, and I think we admitted as much in our filing. But, Your Honor, the principle, I think, is the same. The principle is that we have claims and we have administrative expenses. And administrative expenses are not claims, and administrative expenses should not be offset against claims.

THE COURT: So, you don't think that the definition of claim in the Bankruptcy Code is sufficiently broad enough to encompass payment of an expense that's due?

MR. EPPS: I understand your argument, but I think

that the Ames Court got the issue correct. The Ames Court, in my reading, addressed that question front on and said they understand the argument, but that isn't sufficient to put them all in the same package together, and that administrative expenses are a different breed of cat from a claim.

And what is happening here, if the debtor gets its way, is that administrative expenses are going to be absorbed into the vortex of the prepetition estate, which this Court has to administer. And I believe that the fact that they are, in this case, they may be setoffs as opposed to 503(b)(9) doesn't change the fundamental issue. Our clients have run up administrative expenses in one form or another which haven't been paid at this point. And now what's going to happen is contrary to -- if the debtor gets his way, contrary to what the code says that they should be paid at confirmation, they will not be paid at confirmation. There will be an effort to offset them against a prepetition claim that goes the other way. Now, the dollar effect of this is pretty substantial I think as the Court can understand by reading the disclosure statement. They were offsetting ten to 13 cents against a buck. And I submit to the Court that that is not, as Ames' Court said, that is not the way the code should be read, and that the expansion definition of claims is inappropriate.

But, I would like to tell the Court also what is going to happen if the Court does this. We've seen this in

other cases. What we have when we have an administrative expense is the right to be paid at confirmation. Now, what is being asked is for that right to be abrogated and the administrative expense that is subject to a theoretical right of setoff can be held until the setoff issue is resolved in the fullness of time by this Court. That can be years. Indeed, we have cases where it has been years.

But, it's more than just the timing. The two other issues that are effected here, number one is, will there be money to pay those administrative expenses two years from now? We don't know. The Court doesn't, and no one knows. There's no provision to put that money away for the rainy day.

And the second thing is, which as we've seen in other cases just as well is, what the Court is being asked to do is to give the debtors a hammer, and none of these administrative expenses will be ever paid at 100 cents on the dollar if the Court grants this motion. In the practical world, the Court is being asked to completely upset the balance of power in the claim objection process because the administrative expense, which was incurred in your reliance upon the code, would have been turned on its ear. And we'll have to wait until these other issues are decided before any administrative expense is paid.

Now, in addition -- well, I'm sorry. I will wait if the Court wants to do this in two pieces. The rest goes to the

502(b)(9). But, I don't believe that there is substantial difference in what's really being asked. I understand the statutory issue is quite different, but I don't think it's --

THE COURT: Your argument on the setoff is that the claims are not mutual.

MR. EPPS: They're not mutual and that there are claims versus administrative expenses, which I believe under Ames is inappropriate to be matched up against each other. And furthermore, I would ask the Court in this regard that if the Court does not agree with the Ames Court in this respect, that -- because I think Ames is the clearest voice that we have so far on these issues, that it be addressed because -- by the Court, because I do think that's where we are --

THE COURT: All right, thank you.

MR. EPPS: -- is at that essential bifurcation. Thank you.

THE COURT: Thank you.

MR. HOFFMAN: Good morning, Your Honor. Matthew Hoffman from the firm of Duane Morris representing Audiovox Corporation and Sima Products Corporation with regard to their responses to the 50th omnibus objection. I'm a member of the Bar of the Commonwealth of Pennsylvania and the State of New Jersey appearing before the Court pursuant to Local Rule 2090, with my colleague Denyse Sabagh, who is a member of the bar in this Court.

I'm going to make a series of alternative arguments today. And as Mr. Galardi had said, we're really just going to take the reverse of the positions they've taken. To start with, we argue that the debtors may not set off claims based on receivables against any administrative expense claims, whether post-petition or prepetition 503(b)(9). In support of that proposition, we would look to the Ames case, which has already been cited and the recognition that administrative expense claims under 503(b) generally are not to be treated the same as unsecured claims. I would also point that the Plastech case and the TI Acquisition case, which recognize that with regard to 503(b)(9) claims in particular.

In the alternative, to the extent the Court finds that the debtors may set off receivables against administrative expense claims, to start with, we would argue that post-petition admin claims can only be set off with post-petition receivables, receivables arising under transactions that occurred post-petition. To permit the debtors to set off prepetition receivables against these post-petition receivables would undercut the principle of mutuality underlying the Setoff Doctrine, and we believe there's case law in support of this. The decision in TSLC1 Inc. 332 Bankruptcy Reporter 476, a 2005 case in the Bankruptcy Court for the Middle District of Florida, where the creditor held both prepetition, general unsecured and post-petition

admin claims. The Court required that the setoff of prepetition receivables be as against the prepetition claim before going to admin claims. We believe this case distinguishes the PSA decision upon which the debtors relied in their objection and upon which the ABC-Naco decision also relied, which is another case that the debtor cited to in their objection. In the PSA case, the debtors -- or the creditor rather -- only held admin claims, so there were no prepetition claims against which to offset the prepetition receivables.

Now also, to the extent the debtors can set off receivables against admin claims, this time with regard to 503(b)(9), we would say that the debtors need to setoff prepetition receivables first against general unsecured claims prior to going after the 503(b)(9) claims. Most of the case law that the debtors cite to in support of their proposition is pre-BAPCPA and we believe that Congress made clear that 20-day claims are entitled to a special recognition. That's also what the Second Circuit Court of Appeals found in Ames and what the Bankruptcy Court in the Eastern District --

THE COURT: I thought the Ames case didn't reach the 503(b)(9) issue.

MR. HOFFMAN: Right. That was with regard to just to 503(b) claims in general and admin claims. The Plastech case did recognize the special treatment that 503(b)(9) claims are entitled to. And I would also point to the TI Acquisition case

that's been cited in the papers.

We certainly understand why, you know, the debtors want to do what they're trying to do, to set off against the higher priority claims. But, we don't believe that the Court's equitable powers to do so are enough to really make that step in the face of congressional intent, and also case law in support of the proposition that we're stating.

Finally, in the alternative, if the Court will not, just by rule, setoff prepetition receivables, first against unsecured claims then against 503(b)(9) claims, we would argue along the lines of the mutuality underlying the setoff doctrine, basically that receivables arising from post-petition transactions be used to offset post-petition admin claims, receivables arising from transactions occurring within the 20 days prior to the petition be used to offset 503(b)(9) claims and anything from before that be used to offset general unsecured claims in the alternative and as an equitable solution.

So, basically arguing the opposite and requesting the opposite of what Mr. Galardi asked for, we're asking first that no admin claims be offset by receivables. Then if they're going to be, no post-petition admin claims be offset by any prepetition receivables, that prepetition receivables be used to offset 503(b)(9) -- I'm sorry -- general unsecured claims before 503(b)(9) claims, or in the alternative that they just

go based on timing. You know, post-petition versus post-petition, 20-day versus 20-day, and general unsecureds with everything before the 20-day claims. Thank you, Your Honor.

THE COURT: Thank you, Mr. Hoffman.

MR. LEVY: Good morning, Your Honor.

THE COURT: Good morning.

MR. LEVY: Fred Levy, Olshan Grundman. My admission pro hac is pending. I'm here with Mona Murphy of Akerman Senterfitt, our local counsel.

THE COURT: You may proceed, sir. Thank you.

MR. LEVY: Thank you, Your Honor.

Your Honor, we represent two creditors in this case for the purposes of this part of the argument. Thomson Inc., which has a $283,000 receivable asserted against it, a general unsecured claim of 281,000 and a 503(b)(9) claim of 446,000. We submitted a response to the objection on the docket at 5,518, part of responding to the debtor's 48th omnibus objection.

In addition we're representing ON Corp. in conjunction with Korea Export Insurance Company. ON Corp., which filed the underlying claim, has a $380,000 receivable asserted against it, has filed a $1.7 million general unsecured claim, and it has a $7.7 million 503(b)(9) claim. And Mr. Galardi has presented an interesting argument to this Court.

But, I think boiled down to its essence, he would like to go back before BAPCPA before 503(b)(9). Because if we were in that time and we were before Your Honor, the debtor would be offsetting the receivables against general unsecured claims, and that's the way it was always done. Whether putting aside the argument of pre to pre, post to post, that's the way it was done. You have the receivable, you have the general, unsecured claim, that's what you'll be talking about. But, that's not where we are today.

Congress has amended the Bankruptcy Code. Congress has determined its policy of equitable distribution includes giving previously general unsecured creditors a bumped up, elevated admin claim for those 20-day goods. Congress has determined that it enhances the overall purpose of the Bankruptcy Code to give suppliers those claims. And as Colliers has said, although it's not articulated so well by Congress, but what that does, it encourages suppliers to deal with a distressed company. And that's one of the things that the Bankruptcy Code has tried to do.

Now, with the motion before you, the 503(b)(9) claim will be depressed and treated the same as a general unsecured claim. There will be no distinction and no difference in distribution for the 503(b)(9) claim and the general unsecured claim. Suppliers will get no benefit from 503(b)(9). In fact, what the debtor is doing is eliminating 503(b)(9). The debtor

is asking Your Honor to substitute your judicial discretion for Congress' intent in the Bankruptcy Code. And we know that Congress gets to write the laws and Congress gets to determine what is equitable in bankruptcy distributions.

Bankruptcy is not about equal distribution to all creditors. It's about equitable distribution to all creditors. And that equitableness is determined by the priorities of the Code -- in the Code, and one of those priorities is 503(b)(9). So, to treat a 503(b)(9) claim the same as a general unsecured claim violates Congress' priorities.

THE COURT: Well, would the debtor have the right to set off a claim that it has against a priority claim?

MR. LEVY: It has the right to set off, but the issue before Your Honor is the allocation when there are multiple claims.

THE COURT: Well, let's say that a creditor had a priority claim and a general unsecured claim, could the debtor offset against the priority claim?

MR. LEVY: Not if the creditor opposed it. And Mr. Galardi and the debtor here is saying what authority -- when they look at the code, they say there's no statutory authority. Then they think, what is a case that allows the debtor or Your Honor to decide what the allocation should be? What is that case? Where is the authority to do that? They cite one case, In re Martinez. In re Martinez is absolutely distinguishable

from what is before Your Honor. In re Martinez says that in a reorganization or rehabilitation scenario, the Court has the power to allocate the offset. And Martinez is part of a series of cases that look back -- and Martinez, in fact, recognizes this -- to a United States Supreme Court case. And that case is United States v. Energy Resources 495 U.S. 545. And Martinez relies upon Energy Resources for this holding. And it states -- and Martinez states as follows. The Supreme Court held that a Bankruptcy Court had the authority to direct allocation of payments to the IRS for certain liabilities where, "The Bankruptcy Court determined that the designation was necessary to the success of a reorganization plan." That's not where we are here. This is a liquidation.

Martinez and the United States Supreme Court in Energy Resources do not support the ability of this Court to use its discretion to determine the allocation of the offset. Yes, there are cases which talk about the allowance of the offset. This is not an allowance case. This is an allocation case. Virtually all, or the overwhelming majority of cases that emanate and rely upon Energy Resources in the Supreme Court hold that that allocation discretion is limited to reorganization or rehabilitation, and the necessity to support that. That is not what we have here.

There is no authority, and certainly there is none cited in the papers before Your Honor. The debtor has no

authority to do this. And, in fact, not only don't they have authority, but it contravenes the congressional intent of 503(b)(9). It's recent law. I hear -- it's in their papers, I heard it today. The fact is, recent law doesn't mean that it's bad law, doesn't mean that Your Honor should overturn it. It shows that Congress has looked at the situation in bankruptcies today and saw the need to protect the suppliers.

Now, they want to take away that protection and nobody knows what effect that will have on all the other distressed business situations in this country today. It will -- certainly suppliers will say, 503(b)(9), it's worthless, we're not going to ship to them. Put them on COD, whatever. So Congress' intent here is very important and should not be easily overridden. Thank you, Your Honor.

THE COURT: I thank you.

MR. ZEMANIAN: Good morning, Your Honor.

THE COURT: Good morning, Mr. Zemanian.

MR. ZEMANIAN: Pete Zemanian appearing for Tivo as local counsel. And let me just punctuate one or two of the points that were made by Mr. Levy very well. Tivo's briefs essentially align with the argument that you've just heard. First, in a global perspective, the debtor is asking you to exercise your equitable discretion in connection with setoffs as the Ellers (phonetic) case long ago made clear this Court's equity is limited by the framework of the Bankruptcy Code. And

as Mr. Levy has very well articulated, the Bankruptcy Code includes administrative expenses and puts them up above other claims. To use Mr. Galardi's terms, these have exalted status. And I don't think he meant that with respect, I think he meant that in a belittling fashion, but the exalted status is there, nonetheless.

THE COURT: But, the Congress didn't change Section 558 to preserve the right of the debtor to exercise its state law setoff claims that it would have. It just said that, to the extent that there was going to be a distribution, that these claimants would be entitled to administrative priority, didn't it?

MR. ZEMANIAN: That's correct. But, neither did Congress change 553, which preserves the right to setoff to the benefit of the creditor. And to the extent that these setoff --

THE COURT: Well, where does it say to the benefit? It just preserves the right.

MR. ZEMANIAN: I'm sorry. Preserves the right. It doesn't say -- but it does not -- that's not available to creditors. It preserves the rights to set off whatever those rights are.

THE COURT: Right. And limited only to be able to setoff prepetition against prepetition.

MR. ZEMANIAN: There's a mutuality requirement in

there, as well, Judge.

THE COURT: Right.

MR. ZEMANIAN: Tivo's position, I think, is a little more basic, which is, to the extent the debtor is going to be offsetting against administrative expenses, direct them in the spirit of Section 553 to exhaust the prepetition claim first. Because that is a right that is available -- that is preserved, excuse me, to the creditors.

THE COURT: Well, let me -- here's the problem that is bothering me. In all this argument nobody has really addressed this, and that is, taking it just from your client's perspective, you owe money to Circuit City.

MR. ZEMANIAN: Yes, sir.

THE COURT: Okay? And if you're getting dollar for dollar that debt forgiven, how have you been harmed? I mean, you're not having to pay those dollars. It's much like Mr. Galardi was getting at with the closed bargaining. If we could just distill the whole bankruptcy process down to one microsecond and say everything's going to happen, you know, all at once, which of course we know doesn't, but isn't the effect that your client actually is getting, you know, the full benefit of not having -- by way of the offset by not having to pay those dollars to Circuit City?

MR. ZEMANIAN: Well, to the extent that this Court could distill this down to a microsecond, that might make

sense, but of course it can't. And in that process, to the extent that there are unsecured pennies on the dollars claims left behind, you have deprived a creditor such as Tivo of its offset price. And I don't know what's going to happen down the road. I don't know if there's -- right now you've made it very clear, and that's a comfort to creditors, that there will be no affirmative rights -- excuse me -- affirmative orders being entered. Tivo is not going to have to tomorrow, pay whatever dollars are left once the debtor offsets them the way they want to offset. That's a comfort. But, nevertheless, the debtor will have been given a global order that allows them to do things in the top down fashion they've described. That's not fair to the extent that there is subsequent hearings in which Tivo is going to be put in the dock for the amounts that are left behind, and that's why there ought to be, if not a bottom up, then an exhaustion remedy first. Section 553 is there and it preserves rights, those rights ought not be prejudiced by any global order, especially in the context where we have situations where the facts aren't known, going back to the very first discussions we had today.

THE COURT: All right.

MR. ZEMANIAN: May I also echo Mr. Levy's good argument. It says, in the context of what authority is there? The one case offered is Martinez. Judge Martinez is distinguishable for all the reasons Mr. Levy said, but also

because it involves tax claims, and as we saw on the Kraft decision, tax claims are sometimes different. I submit to you that they are different in this context. And then of course we also echo the notion that the purpose, to the extent you can distill any purpose from BAPCPA or the Bankruptcy Code in general is to encourage vendors to deal with distressed parties, either pre-bankruptcy or certainly post-bankruptcy. And to the extent this Court is exercising its equity, please keep that in mind as you do so.

THE COURT: All right, thank you, sir.

MR. ZEMANIAN: Thank you.

MR. ENGLANDER: Your Honor, I join the prior arguments -- Brad Englander for Alliance and Source, join the priority arguments. I think as to the tax claims, those are significant, they're distinguishable. Here Congress set up a priority that is intended to induce private parties to enter into certain sorts of behavior, to continue shipping goods. And considering the equities of the case, one needs to look at that.

The situation the Court has before it on the merits here, actually I think Mr. Galardi almost makes my point. And the reason is this, 558 and 553 preserve state law rights. Under state law there is no priority claim. There's a claim. And Mr. Galardi points out that the 503(b)(9) claim is a claim. It has priority given by Congress. It's like, however -- it's

analogous to a secured creditor who is under secured. In that circumstance, take a creditor who has a $2 million claim and a one million dollar piece of collateral. And during the course of the case, money is paid on account of that claim, adequate protection. Well, that adequate protection is going to reduce the amount of the claim, I think we can all agree on that, because it's an under secured creditor. But, at the end of the case you don't say, well, the secured claim went down. If the claim is reduced from two million to a million five during the course of the bankruptcy case, it's still a million five. And there's still a million dollars collateral and that creditor has a secured claim to the extent of the value of the collateral. That's a very analogous circumstance. We have a claim that exists, under law, outside of bankruptcy. That claim may exist by virtue of a contract, it may exist by virtue of shipments on open invoices. Whatever the nature of it, there is a claim, and the rights to set off against that claim may very well be preserved under 558 or 553, as the case may be.

But, how it gets characterized is a different matter entirely. We have a policy driven by due process and takings clause concerns for protecting collateral, protecting property interests, and that's preserved in the bankruptcy. Similarly, Congress here has set a priority in Section 503(b)(9) to induce creditors to continue doing business with debtors on the run up

to the bankruptcy. It's Congress' policy, but it's a good policy, and it's equitable to protect that. Now, if the debtor wants to assert any sorts of rights under 553 or 558 it can do that, but what it doesn't get to do is wipe out the priority portion.

Now, I submit again, and I'm going to delve back a little bit into some of the arguments I made on the procedural piece of this because I think that they're very related, is that the Court's going to have to look at the facts and circumstances of each case in deciding ultimately whether there is a setoff or some sort of an allocation here. But, what is clear is that the Court's determination of how this works does seem to involve, under the cases, some equitable discretion on the Court's part, and that every Court that's looked at it and considered this particular issue has said the Court has to have those facts in order to make that equitable determination. Because the Court will find facts, and I know this because I know what our facts are, where the equities are different. The facts of whether there is a setoff, versus a recoupment, versus simply a method of calculating the claim is going to be very relevant to the Court's ultimate determination, as is the timing of the events that lead to the so-called setoff.

And again, I would ask the Court to consider these facts, at least as hypothetical facts. They're not in front of the Court, but consider this. You have credits that arise

under a contract well before the bankruptcy is filed. They're out there, they're still sitting out there for whatever reason. Perhaps the paperwork hasn't been done. But, all of the factual events that give rise to those credits have occurred before the 20 days even prior to the bankruptcy. And then during the 20 days, the creditor continues to ship product on a credit basis to the debtor, doing exactly what Congress sought to induce that creditor to do; deal with the debtor on a credit basis. And then the debtor comes in afterwards -- and then during that period, during the 20-day period and during the post-petition no events occur that give rise to any of these setoffs or credits. All of them are in the past. Then the debtor comes in, or trustee comes in or the estate comes in and says equitably we want to wipe out all the good deeds that the creditor did by shipping on a credit basis during the 20 days prior to the bankruptcy based on things that occurred before that period even arose. That's the sort of factual distinctions that you're going to come into when you look at each case. And what I'd ask the Court to do, and I do adopt all of the policy arguments that have been made, I think that the Court should reject the debtor's request to adopt this sort of broad brush program. I think, as I said before, that the Court should defer a ruling until it has actual facts in front of it. But, what I would urge the Court to do is that if it is going to move toward the debtor's position in some general way,

that it preserve not only its ability to look at the facts, but to make the equitable determinations that are the basis for the debtor's argument in the first place.

THE COURT: All right, thank you.

MR. ENGLANDER: Thank you.

MR. JOHNSON: It's still good morning.

THE COURT: It's still good morning, yes.

MR. JOHNSON: Good morning, Your Honor. Russell Johnson here on behalf of Averatec Trigem. I'm not going to rehash the arguments that have been made, but I do have a different type of spin on this based on my client's facts of this. But, first I want to first say that the authority the debtors rely upon, there's really, there's only the one case, the Brown and Cole case where they said that they could do this. The Court equated the 503(b)(9) claim to a prepetition claim and we submit that that reasoning is wrong, and that's really the only case that they have factually that supports their relief that they're seeking against my client. And let me explain what I mean by that.

My client, as I mentioned earlier, has a 440,000 some thousand dollar unsecured claim. They have a $321,000 503(b)(9) claim. When you look at the other cases that the debtors cite, let's look at the ABN -- I'm sorry -- ABC-Naco decision. The creditor there did not have a prepetition claim, it just had an administrative claim. If you look at the PSA

case, that case, the PSA creditor did not hold a prepetition general unsecured claim, it just had an administrative claim. The Women First Healthcare case, the claims were both prepetition claims in that case that they were talking about. And why I say this is significant is, if the debtor has a claim, $197,000 claim, that they claim against my client -- well, let me go back for a second. If the debtor has a $190,000 claim against a creditor that only has an administrative claim -- let's go back and change the facts for a second. If the debtor has $197,000 claim that they can file an adversary proceeding for to collect, and assuming that claim is right, they get $197,000 judgment against that particular creditor. But, that creditor has, let's say $100,000 administrative claim. I can see in that particular context where you would want to do -- where the offset might make sense, because the debtor has $197,000 real money claim that it sued for against the $100,000 administrative claim, so that threshold might be able to make sense in that context.

Here, however, we don't have that same threshold context. We don't know from the facts what their claim relates to, the 197 against my client. And this is why I think it's important. We have one contract, in fact, all I'm told is we have one contract with them. We don't know what their claim relates to. Does it relate to the contract? If it relates to the contract, it seems to me that their claim is a recoupment

claim that comes underneath that contract and we can figure out, does it relate to invoices that were part of the 503(b)(9) claim, or does it relate to invoices that were before the 503(b)(9) claim? And that's where the facts become important. Because why should they be entitled to offset or recoup, whatever you want to call it, the 197,000 that might relate to the $441,000 worth of invoices when they had nothing to do with the 321,000, they're the 503(b)(9).

I don't see how -- that's why the factual record here is very important with respect to my client, or is their claim something completely separate? Is their claim outside the contract? And in that case, then what is their claim and what is it then, or are we just talking setoff?

But, I think it's important though when you look at the cases first, they haven't allowed a situation, there's no cases that support their position, that they can take and pick and choose where they can offset. There's not a single case that says other than the, what is it, the Brown and Cole that says you can pick and choose. In contrast, all the cases that are cited in my brief, Plastech -- well Plastech is more on the 503, 502 issue, but Genuity, Southern District of New York case. There, the creditor had an assumed contract. Here's another situation where all of a sudden a prepetition claim becomes an administrative claim. In that case, the debtor wanted to offset monies from prepetition security deposit

against that cure claim, and the Court said, no, would not allow that unsecured claim to be asserted against the administrative cure claim, which is a prepetition claim, that because of the Code now has sprung and become an administrator.

So, we have direct authority, Genuity, that says, no, you can't do this, you can't allow them to cross these barriers. They can't use their unsecured claim against an administrative claim. That case, very similar to our situation here, both are priority claims.

Then you have -- I'm not going to go into the TSLC1 that has already been argued. We've added cases not cited by others. The Lawson case, the Official Labor Committee v. Jet Florida and the Braniff Airways. All of those cases would not allow the debtor to offset an unsecured claim against a secured or administrative claim; all those cases. And so all we have is the Brown and Cole, the Martinez case, which I think has already been addressed ad nauseam, I'm not going to address that, and as I said, the ABC-Naco case, there the creditor didn't even have a prepetition claim, just had a post-petition claim. So, it's different than our scenario here.

And as I mentioned, my clients' facts are such that the unsecured claim greatly exceeds their purported claim and then you've got, in addition to that, the 503(b)(9). So, first I guess I say, they don't have any authority other than that Brown and Cole case and the Martinez case, which I think have

been thoroughly addressed. The other cases that it rely upon aren't the same facts. They're not the same facts. It's not the facts that relate to Averatec. And I don't know everybody else's facts here so I don't want to go into those arguments, but they don't support that they're seeking against Averatec. And we've cited plenty of cases, I think Genuity is the best one, that says you can't to this.

Your Honor, the other argument I'd like to make is that, if they were to have actually filed their claim against my client, the 197,000, they just filed an adversary proceeding instead of doing it by an offset, or by a setoff, my client would then be entitled to determine what offset it wanted to assert to that claim. So, they're trying to flip the tables here, and is that proper? I don't think it is. Because if they sued us for that 197,000 instead of making us an offset claim, my client could decide what invoices it wanted to assert as a setoff against that claim, but now they're telling this Court, well, we asserted it as a setoff, so we want it to go against these priority claims first before that and it takes away our right if they're seeking that affirmative relief to this -- for us to assert what claims that applies to. The arguments have been made that the Congress established a priority scheme that they're trying to upset the apple cart on by asking this Court to apply their claim against the higher priority claims first and I just don't think that's proper.

THE COURT: All right. Thank you. Does any other party in the courtroom wish to be heard? Is there anybody on the phone that wishes to be heard? All right. Mr. Galardi?

MR. GALARDI: Your Honor, do you want me to reach the confirmation issue before I go on about what's going to happen with confirmation or the -- because --

THE COURT: You may because I think that there is some confusion about that.

MR. GALARDI: With respect to confirmation, again, let's just talk about temporary disallowance, the plan. I think the plan is pretty clear. People may not like it, but hear of what the plan provides. If it's temporary disallowed it doesn't get a distribution. That's if there's an objection to a claim it doesn't get a distribution. And I believe if the plan is how I normally draft them there is an allowed claim definition, a disallowed claim definition and a disputed claim definition and the disputed claim definition tails into the objection deadline by which we must file claims. And, so if you had a disputed claim under the definition of the plan although an objection has not been filed yet, there's a time limit, but you don't get a distribution until that objection is resolved.

That then goes to 1129(a)(9) which I understand people want to hear about today, but I think that's a confirmation objection that I fully expect people to raise.

Well, how can you pay the Hewlett-Packard? And our intention is to pay Hewlett-Packard the $6 million claim on confirmation because it will hopefully if nobody objects have an allowed 503(b)(9) administrative claim and I do read that to say if it's an allowed on the effective date you pay it on the effective date.

Most people will not have an allowed claim, so what I fully expect and I'm sure now that everybody will take notes and I will expect hundreds of objections saying our plan cannot be confirmed because we're not paying claims on the effective date.

THE COURT: I'm hoping for hundreds of settlements.

MR. GALARDI: I wish they would all settle too, Your Honor, but let's assume that they don't. That goes to the feasibility. It goes to whether I have to set up a reserve to confirm a plan to show that I can satisfy it. It doesn't mean that I have to pay them on the effective date if they're not allowed claims. That will be an issue we'll all litigate probably and we'll take about when we're going to go forward with confirmation, but that has nothing it do with today's issue other than it may have created confusion. But, the temporary disallowance is simply to say if you had an allowed claim otherwise, so if I -- if, for example, the gentleman that says this is disallowed, but I have seven million allowed and we agreed between now and confirmation that the allowed amount

is that, they'd get the distribution. That's how that works. So, I, you know, not hiding the ball there I know my definitions from the plan.

Let me go to what I still don't understand and Your Honor raised it and what everybody seems to ignore. First of all 558, 558 says the debtors have all their defenses. That means I have a setoff defense. It doesn't say, "But, you can't use these defenses against administrative claims." It doesn't say you can't use them against 503(b)(9) claims. It says you have the full -- even if you waived them pre-bankruptcy, you can't waive them. You have all of your defenses.

So, let's take your ordinary course State court offset. Mr. Johnson again raises this. Well, let's assume I had this really old offset that, you know, I haven't decided to use yet, but nobody disputes it. Well, there may be a good reason I didn't use it because I have an ongoing business relationship and I didn't want to use it at that point. But, if there comes a day, let's assume it was 40 days before bankruptcy and you gave me an invoice, I could use it then. Or if it's 19 days before bankruptcy, I could use it then. And if it was ten days after the bankruptcy, I could use it then. It may mean that they don't ship goods after that, but there's nothing that precludes me under the bankruptcy code or under State law from at some point getting an invoice, asserting my offset right and it would have had exactly the impact that I

wanted it to have. If I had waited and not paid everybody and everybody was coming in the other day saying, “Well, you got to pay your administrative claims.” We could have started to use those offsets during the course of this case when we were an operating company. We didn’t. We could have done that. They could have said, no. But, we didn’t. It -- that’s my State law right to use my offsets.

So, 558 says I can use it and nothing has changed whether it’s 503(b)(9), whether it’s 503(b) or whether it’s a ordinary pre-petition unsecured claim. I have my rights. I have the offset rights. I could assert them and they can deny it and nothing in 558 -- though they put 503(b) in there and 503(b)(9) in there. They didn’t say, “But, now you can’t use 558 for that purpose.” They never said that. And as the gentleman said the law and the practice before we gave it to the exalt estate and I didn’t say it in a sarcastic way. It is. Administrative status is a very good thing, but you could have asserted it and I could have asserted it and nothing about changing 503(b)(9) and given this carve out changed anything that I could have done. So, I think 558 gives me the rights.

The other thing is think of the following example and 553 says you can -- they can setoff as long as it arose before the commencement of the case. I think Your Honor pointed out it doesn’t give them the discretion which of the pre-petition. It doesn’t say what’s ever best for the creditor. So, let’s

just take the following example. Let's assume very simple I have to use small numbers because I'm not that quick. An unsecured claim of $5, a 503(b)(9) claim of $10 and I have a $7 offset. Are they saying that I can only use $5, but I still have to pay the ten or do I -- or are they saying that I can -- have to go first to the five? They're giving an exhaustion remedy that I have to first exhaust one pot before I exhaust another pot. There's nothing in the code that says that and there's nothing in the code that says I have to do it that way.

As my example said if I wanted to and I happen to know I was filing tomorrow I could have used my offset right then and there. I could have stopped the 503(b)(9) claim. I didn't because we wanted to have an operating business, but I could have used my full offset right then and there against that ten million and nothing could have stopped me. They wouldn't have had the 503(b)(9) claim and what would they have done then? Oh, that was an invalid offset. What, State law would have let me do that. So, I don't see the argument.

And then to talk about congressional intent to get people to continue to ship in the 20 days, there was no congressional intent. We'll get to this on 503(b)(9), but there's no congressional intent here whatsoever. As if these people knew I filed 20 days, so they extended credit. Every one of them as soon as I filed didn't extend credit. They didn't want to extend credit. So, to talk about that this is

somehow the great thing to keep bankruptcy retailers alive is just disbelievable in my view. There's no detrimental reliance.

So, Your Honor, we think, you know, the law actually is pretty clear, 558 was not amended, 558 gives me my State law rights. My State law rights are to exercise my offset rights whenever I please to exercise them and, yes, it may have an implication on the status or priority of their claim, but it doesn't say I can only do it. In fact, my fiduciary obligation it seems to us is to use them as effectively as possible to maximize recovery and no one has yet answered your question or my question is well, if we can do this instantaneous bankruptcy and bring the money in how are they really harmed here? They're harmed because they don't get a windfall on their pre-petition unsecured claim. That's the only answer they can give. And that's nothing that Congress intended for them to have. Congress intended for them to have a setoff right. If all they had was a 503(b) claim they would have to use it and it would be reduced. It just so happens they want a windfall on their pre-petition claim.

So, Your Honor, we would ask you to enter the order allowing us to setoff and, again, we believe we can exercise it under 558 just at any time with respect to any claim. I think they want to go the opposite priority, but even many of them conceded that at least with respect to 502(b)(9) it's a pre-

petition claim and it should be allowed to be exercised against the 503(b)(9) claim. And if Your Honor has any questions for me?

THE COURT: No, Mr. Galardi. Thank you.

MR. GALARDI: One other point and I guess it will come up, but I think it's irrelevant and I'm sort of going to dare people before lunch. Ames, I hope people actually read Ames because Ames does not say expenses are different than claims.

THE COURT: I've read Ames.

MR. GALARDI: Okay. I know you have, Your Honor, but I keep hearing this. Expenses are different than claims. The sentence says, "Because claims for administrative expenses may not be filed under 501, they are not 502(a)." It's not that the claims and expenses are different. It's they're treated differently. Now, I may disagree with their conclusion, but Your Honor raised the point claims is a right to payment. That's different and they, you know, a payment -- an administrative expense is a right to payment. It's a debt. It's a liability. It's a claim. The issue is do they get treated differently for the next argument under 502(a), 503? Thank you.

MR. CARRIGAN: Your Honor, may I attempt to answer Mr. Galardi's hypothetical? And actually I think goes to --

THE COURT: Certainly.

MR. CARRIGAN: -- question you asked. He says there's five bucks pre-petition claim, ten bucks 503(b)(9) and the debtor has an offset of seven. Let's consider the offset and it's post bankruptcy and let's consider the offset seven bucks cash that he's got to pay. Where does that seven bucks have to go under the absolute priority rule? Well, it first goes to the five bucks because that's a secured claim and then it goes to the 503 which is the priority claim. That's how it goes and that's the reason that we have an absolute priority rule. Secureds get paid first. The "unsecured" piece of five is a secured claim at least to the extent that that seven bucks in cash is going to be used to make distributions.

So, what's the difference? If it's a pre-petition setoff of seven bucks, it's the same as cash and it's not unfair that the five gets paid. And I think whoever said that you match the pre-petition versus pre-petition maybe the 20 days versus the 20 days and then the administrative versus administrative. You're actually following the absolute priority rule, Your Honor. There's no windfall. There's no bargain. It's a secured claim that's getting paid. It's in the example that Mr. Englander raised and that's the answer.

THE COURT: All right. Thank you.

MR. CARRIGAN: Thank you, Your Honor.

THE COURT: All right. The Court has read all of the papers that have been filed in this matter and this has been

very well briefed and I think everybody for the very thorough analysis that you've given the Court and I appreciate the arguments this morning.

The Court is going to rule in favor of the debtors on this matter. I do -- I think that Section 558 does preserve the debtors' State law setoff rights and there's nothing in Section 558 that says that it's limited to certain types of claims. The bankruptcy policy certainly favors equality of treatment among creditors and Mr. Galardi raises the argument about the debtors' fiduciary duty to maximize that and to apply the claims that the debtor has to maximize a value for the estate. Section 553, I don't think creates any kind of a scheme of priority of setoff rights in favor of creditors. It merely preserves a right. It doesn't create any rights.

And finally, with regard to, you know, what's really going on here. Satisfying creditors' claims by extinguishing the debts that they owe to the debtor does not in any way erode the value of the claims that these creditors are advancing or alleging. They're getting, you know, dollar-for-dollar relief of their obligations. I think what we're mixing apples and oranges when we talk about that from the distribution side which is something entirely different. So, the Court will rule in favor of the debtors. They may apply the offset as they deem appropriate to maximize value of the estate.

Mr. Galardi, I would ask you to please prepare and

submit proposed findings of fact and conclusions of law. The Court does intend to write a memorandum opinion and I will issue an appropriate order at that time, but I did want the parties to know what the Court's ruling was going to be.

MR. GALARDI: We'll do so, Your Honor.

THE COURT: All right. You may proceed to now to the next issue.

MR. GALARDI: Your Honor, obviously another sensitive topic for everyone and this is our 502(d), 503(b)(9). Everyone has today and in their papers taken on what I'll call the Plastech decision as their own as well as the Ames decision on their own although Ames does have the footnote that it really didn't apply. But, let's assume that it does apply. I want to note one thing about Ames and I have a certain view of bankruptcy judges versus appellate decisions. I note that Judge Gerber, a very well known Southern District, actually took the position contrary to Ames that 502(d) applies as did the District Court.

With no disrespect to the Second Circuit because I may find myself there some day, I think their ruling is simply superficial with respect to the 502(a) issue. They are not mutually exclusive by any stretch of the imagination. I point out, again, the following differences. First, the bankruptcy code is really very clear. What 501 talks about is creditors who file claims, creditors who file proofs of claim and the

word creditor appears over and over again in 501(a), (b), (c) and then it talks about a claim of a certain site in another claim, but it is a creditor indenture trustee may file a proof of claim. If a creditor does not file a proof of claim, blah, blah, blah, if a creditor does not timely file.

You got to start with -- the Court seems to be looking at claim in 501 as opposed to who has the obligation and there is a major difference there because creditor if we go now to the bankruptcy code is an entity that has a claim that arose before the petition date, 101. That definition itself says a claim, you know, why would you say a claim that arose before the petition date if claims were simply those things that only arose before the petition date? Those words would be redundant.

What the definition of creditor did was it says you're a creditor if the type of claim you have under 101(10) is the one that arose before the petition date. It's not that the claim makes you a creditor. It's not that the claim had to arise before the petition date. You're a creditor if that's the two conditions. So, again, the Second Circuit goes on and says because claims for administrative expense may not be filed under Section 501 they are not subject to 502(a). That's just false.

Claims are filed. Even administrative claims are filed. The forms have changed. The forms say administrative

expenses that arise after the petition date should not be filed on this form. I mean, it doesn't -- it doesn't -- and this is a may -- it's a permissible. It's not a preclusion. You can still do it, but frankly pre-petition administrative claims can be filed and should be filed. And frankly I'll warn everybody out here if you don't file a proof of claim for a 503(b)(9) expect me to object because a 503(b)(9) claim is a claim that arose before the commencement of the case. It says it. And the form says file -- only don't file those ones that arose after the date, but you are a creditor.

Why are you a creditor? Because it arose -- but, your claim which may be treated to an administrative expense status arose prior to the petition date. Importantly, and again I think you've already alluded to it, the definition of claim is broadly construed. A debt is a liability on a claim and no one in this room is going to say an administrative expenses is not a debt.

So, I think the Second Circuit simply got it wrong and to base a decision on the fact that you don't file a proof of claim for a 503(b)(9) claim which is what it seems to have rested on is just simply not true because you probably do have to file a proof of claim. And if you have to file a proof of claim, you know, all this discussion of whether or not 502(d) only applies to those claims really is largely irrelevant, but we'll go through more of that argument.

Your Honor, again, I happen to be -- and I'm never a fan, but -- except for this instance of the Ninth Circuit. I rarely agree with the Ninth Circuit as -- but, in this instance I think that MicroAge court is directly -- it's just a common sense approach. It takes the definition. It starts with 502(d) language. 502(d) language says a claim of an entity. It does not say creditor. Let's just take the strict language, a claim. They clearly have a claim. I don't think anybody in this room in the -- and I don't think Ames and I challenge people at break to find me where it says an expense is not a claim. They have a claim. It arose before the petition date. They are an entity.

I don't know how 502(d) cannot apply to a claim of an entity that arose before the petition date and to argue that it's not governed by 502 because you don't have to file the proof of claim, that would have two consequences. One, I don't think it's right and, two, does that mean we can't go against scheduled claims for which no proof of claim is filed and say that they're the recipient of a preference and therefore it shouldn't be disallowed? You do exactly that and a creditor can go in and object to schedule claims. But, under this reading you couldn't challenge a scheduled claim because why? It wasn't a proof of claim under 501, so 502 doesn't apply. That's an absurd conclusion. 3007 doesn't preclude a creditor. Debtors can amend their schedules, but creditors can object to

claims and say that person got a preference. So, I don't see the same 502(a), 503 distinction.

Also, if you look at 503 there are other pre-petition claims in there that you still get 503 status, but you're still a pre-petition claim. For example, if you look at 503(b), I guess it's (b)(1)(b), a tax for the period that ended before the commencement of the case, it's still a pre-petition claim. If you look at the -- a government unit for a payment of an expense and they don't even have to file an allowed administrative expense then you look at what is also clearly pre-petition. A creditor that files the petition and the attorney's fees for filing the involuntary petitions. They are clearly pre-petition claims.

But, what did the Court decide? They're pre-petition claims, but you have to -- but you get 503(b) status. And, so if you look at those conditions it's not as if this only talks about post petition administrative expenses. It says they've got a claim, but they get elevated status. And to get elevated status what do you have to do? You take the claim you've got and you make a request for the payment of an administrative expense. You have to do something else. You got to file your claim if you're a creditor which you are if you're a pre-petition creditor, so maybe the only people who get out of this are the people who don't have claims arising after the bankruptcy which is the normal 503.

But, anybody who has a claim beforehand, if I were a creditor and I wanted to get my attorney's fees and I filed an involuntary and I looked at that form and that form says you don't use it if it's an administrative claim that arises after the petition date. It still means you got to file a proof of claim unless the debtors put it on your schedule. If the debtors put it on your schedule you might not have to do it, but if you want special treatment, you want administrative expense treatment, you want to be paid now or you want to be paid full dollars for that stuff, you've got to make -- you've got to take the extra hurdle. You got to go and file an administrative expense request. What does that do? It accelerates the timing of your claim and it says you can get paid full dollars sooner than confirmation, maybe on confirmation.

So, the distinction between claims and -- claims and expenses I think is simply one that all expenses are claims, but certain expense -- certain claims are elevated. They are elevated to get priority and treatment as an administrative expense claim. They're nothing but a subset. You read the definition of claim, it's broad.

So, I think the first thing is those people that rely on the expense versus claim argument should read Ames and what Ames really says is that expenses can be claims. They're just not subject to 502. I happen to disagree. They are subject to

502 if they're held by creditors and that is they have claims that arose prior to the petition date. That's what a creditor is and a creditor must file a proof of claim.

Look through 3001, 3002, 3003 and 501 only talks about when you have to file a proof of claim. It totally ignores 3003 that says by the way you don't have to file a proof of claim if you're on the schedules. But, if you're on the schedules you're not home free because you didn't file a claim under 502. There are plenty of creditors that can object to scheduled claims. They can, you know, they can come in and say, "I don't want to pay that person because they got a preference." That's legitimate. Don't tell me we can't go to 502(d) and say that because they didn't file a proof of claim. That's a silly defense.

So, I think the distinction that those Courts draw between 501, 502 and 503 is just simply not a viable distinction. Rather the distinction is 501, you file a proof of claim if you're not scheduled, 502, if you're a creditor you have to file a proof of claim. Why? Because you're a creditor and that's what 501 said and they didn't file a proof of claim on your behalf, 502, you do it and 503 says, well look, you can get some of those pre-petition claims to exalted status as an administrative expense, but by the way if your claim doesn't arise until after the petition date you got to use 503 because you're not a creditor. That's not mutually exclusive. That's

variations of how you get your claims paid in the priority scheme.

So, once we get to that point, Your Honor, it seems to me 502(d) is straightforwardly a statute that says look, if you have a claim it's a claim of an entity, no doubt, if you're subject to avoidable preference you cannot be paid that amount until you return it. Now, we didn't take the radical position. Under that radical position if I had a $2 claim and they had a million dollar 503(b)(9) technically this statute says what? It says you don't have to pay them anything on that 503(b)(9) until they give you the $2 back.

It was meant to be if we look at the legislative history of 57(g) and all the policies it was meant to, so that a debtor doesn't have to chase people down to get the money to come in before making distributions. That was the intent of it and that intent is served whether it's a 503(b)(9) claim or whether it's a pre-petition unsecured claim. And it's even served better on 503(b)(9) because with respect to the pre-petition unsecured claims most people don't want to pay you the real dollars to get their unsecured claim. Here, it's important to get the real dollars, so you can pay the administrative claims. So, those purposes are actually better fulfilled in that.

With respect to the other distinctions between administrative expenses and claims, again, Your Honor, there's

plenty of sections. 3001 talks about -- I mean, five -- you know, MicroAge goes through a number of statutes where the claim and the classifications of claims whether they're administrative expenses. So, Your Honor, we think clearly that 502(d) would apply to the 503(b)(9) claims. They're pre-petition claims held by a creditor. You don't even need a creditor. Some people go back to the legislative history and I guess Ames didn't think it was clear.

Well, as the papers pointed out prior to the bankruptcy code it applied to creditors, but creditors included both holders of claims, pre-petition and post petition. So, they had to change the language to get an entity because they were distinguishing as I just pointed out with 501 and all the other provisions the creditors were now only those people who had pre-petition claims, not post petition entities. If they had put a creditor here in 502(d) I wouldn't -- we'd still have an argument about the distinction pre-petition.

But, here they have an entity, so whether we slip and slide all the way into the post petition I don't think is an issue for us to decide today, but I think it can cover even 503(b) claims, Your Honor. But, clearly there is a principled reason why it covers the 503(b)(9) claims. They are creditors. They hold claims. They are pre-petition claims. I believe they have to file proofs of claim especially now that the proof of claim form which makes it clear that it's a claim -- an

administrative claim that arises prior to the filing.

Your Honor, I guess the other things we can say are in the papers. I don't know if Your Honor wants further argument on those points. I can wait to respond to all the other people or we can take up one other legal issue that's been raised, the 502(d), when is it right for -- when is it right to be used so to speak?

THE COURT: Let me ask some questions.

MR. GALARDI: Sure.

THE COURT: You know, first of all the Fourth Circuit has an opinion that is remarkably similar to Ames not dealing with 503(b)(9) claims, but it's the Durham v. SMI Industries case where it said that since a Court can only disallow a claim after one has been filed under Section 501(a) claim and Section 502(d) includes only one for which a proof of claim has been filed and there they wouldn't let the trustee use 502 to defeat an admin claim. Why -- is this Court bound by the Fourth Circuit's decision there?

MR. GALARDI: Well, if the decision were on point with respect to the need for a proof of claim, Your Honor, you would be bound by it. But, again, my view is that the 503(b)(9) claims are claims for which proof of claims should be filed and therefore it's actually --

THE COURT: So, it's --

MR. GALARDI: -- it's distinguishable --

THE COURT: -- distinguished that --

MR. GALARDI: -- all right. Because that, again, that proceeded -- and there were other cases that suggested otherwise, but the point is it is only -- would only be decisive here if you reached the conclusion that a creditor holding a 503(b)(9) claim was somehow absolved of a responsibility to file a proof of claim. I don't see how you're absolved of filing because, one, we didn't schedule them as 503(b)(9) claims. So, two, go to 3003 -- two, they are creditors. There's no question they hold a claim that arose prior to the commencement of the state -- statute. That's what the statute said.

So, if they're not scheduled and it's a pre-petition claim and they're a creditor then I don't see how come they don't have to file proofs of claim. To rely on a form and admittedly a form is nothing but a -- again, we're not going to argue that's not the statute that was enacted by the Supreme Court or whatever to prove. I'm not going to rely on that, but frankly if they want a claim and they wanted a claim of that sort, they have to file a proof of claim.

And then what else did they have to do? They had to come and ask for administrative status, as well. Then they had to make the request. This is why I don't think 502 and 503 are mutually exclusive by any stretch. I think pre-petition creditors have to file proofs of claim. And, so what we did is

there's a form for them to use. It's very much like the proof of claim form, so these people have used that form and we set a separate bar date because we worried about administrative solvency and insolvency.

So, these people did file the proofs of claim. Now, they want to say it was an administrative request, but I think that's a distinction without a difference. Here, if they're creditors the claims aren't scheduled as administrative status I don't think they can avoid the proof of claim argument and I think they have to file it under 502 which is why I think they are subject to 502(d) and why I don't think the Fourth Circuit decision is decisive on this point.

Again, I don't necessarily agree because they were looking at the word claim as opposed to creditor in that decision and I think that's a slippery slope because, again, there are plenty of claims that are never filed like scheduled. I mean, we know at the U.S. Trustee's office if I don't schedule some as -- if I scheduled everybody contingent disputed on liquidated I've already had an argument with the creditors here, they all have to file proofs of claim. If I put in a specific amount you can bet I'm not going to give them a 503(b)(9). If they think that's a pre-petition claim they better file that.

So, I don't think you get out of it. I don't think the Fourth Circuit's decision is dispositive of this issue

because I still believe that they have to file a proof of claim because they're a creditor with a claim that arose prior to the commencement of the case.

THE COURT: All right. And then given the -- that the Court is agreed with you that you have a right to setoff the claims that the debtor would have, why do I need to reach this decision?

MR. GALARDI: Because --

THE COURT: Couldn't you just invoke a right of setoff?

MR. GALARDI: Well, again, if I had setoffs against these claims, yes, I could and I could proceed first there. Some of these are not -- partly why they're in separate objections is that I didn't have sufficient setoffs, so it was people that I would, in fact -- they're not technically receivables. Receivables we think are undisputed. We may have fights about the amounts, but that's a different issue.

THE COURT: No, I'm saying if you have a claim under Section 547 against somebody, why can't you offset that claim against their claim?

MR. GALARDI: Well, because I have to go prove that claim first --

THE COURT: It's unliquidated.

MR. GALARDI: -- and maybe I can, in fact, offset that at a point, but -- and, again, maybe because we sort of

tailored our relief here, the beauty of really 502(d) if I took it as aggressively is I could set it off, but it's even worse for them. If the 502(d) says I don't have to pay them anything until they pay it, but we did what we -- that's why we did it the way we did it. We're just using it as a setoff because we think we're not administratively insolvent. But, in the case that people are worried about administrative insolvency you wouldn't want to do just the setoff. You would actually want to wipe out that administrative claim until you've got the cash in because you could then pay in seven no administrative claims in full.

So, yes, here it's a distinction without a difference, but I understand the receivables language in the 547 is I have a burden. They have certain defenses. Receivables is sort of the ordinary course contract State law notion. This is a different right that I get under the bankruptcy code. They have the right to defend and give various defenses and what it does is it temporarily suspends them for their entire claim although we did a little bit smaller and not everybody has a receivable. I don't consider it -- maybe I -- maybe the simple answer to your questions is I don't consider a preference recovery the same as "an ordinary course receivable" and that's probably why it's not the same relief.

THE COURT: All right. Very good. You can then

address the other issue that you wanted to address.

MR. GALARDI: Sure. The next issue, again, I go back to the Supreme Court case, Katchen v. Landy. Again, everybody says it's a liability, but the language is that it's avoidable and no, I can't just come in and say I've got a preference and not give you any disclosure. But, if I raise the preference defense just like if I raised on objection to claim our reading of 502(d) says, okay, "Shall disallow any claim from an entity that is recoverable." We're not trying to disallow. We're not disallowing it. We're temporarily disallowing it which basically is our phrase for the Katchen v. Landy it's held in abeyance pending the outcome of that litigation. It is neither allowed nor disallowed.

In essence, the presumption that the claim is allowed has been suspended until the preference action or -- in this case our 547 action is resolved. That's where we see Katchen V. Landy did. That's how we've read many Courts to say if you raise an objection and you raise your prima facie defense and, again, we can raise a 547 defense. We make the allegations. It is then their burden under 547 to come back and say it's subject to one of the defenses. But, that is sufficient to suspend payment on it. It doesn't mean it's disallowed. It doesn't mean it's allowed. It means it's neither allowed or disallowed. It's held in abeyance.

And, so we think if you just simply make the

allegations that we are, in fact, entitled to suspend payment on the claim until such time as those allegations are resolved. That's how we read 57(g) and --

THE COURT: Okay. Well, how do you respond to what, you know, Mr. Epps is going to say because he's already said it. You know, where it talks about in the statute 502(d) it says is liable and, you know, many of the memoranda have --

MR. GALARDI: Sure.

THE COURT: -- spoken to that language. How do they know what amount to pay at this point in time?

MR. GALARDI: They don't, Your Honor, but that -- but, again, it's the Court shall disallow when it's liable. We're not saying the Court shall disallow. We're not requiring you to disallow. We are just saying you suspend the lead in to 502 which says the claim is allowed until such time as this is resolved, right? And, so we can raise an objection. They have prima facie evidence of it. When we raise the objection the claim is put into suspension until the 547 action is decided. It's neither allowed nor disallowed very much like my disputed class. Any claims objection does that to some extent, but this one is more -- is different because sometimes you'll object to a claim. It's overstated. It's not books and records.

Here we actually have to bring a preference action -- a right of action given to us by the bankruptcy code which essentially suspends payment allowance and disallowance until

ii's resolved. It may ultimately be allowed if we can't prevail on ours. It may be ultimately disallowed and frankly we could have -- as I said, disallowed it in full, but here because of not concerns of administrative solvency we've taken a more -- a narrow approach to that. I mean, we could have said until you actually pay me cash money back you don't get any claim and that's what the statute really says, but we've decided to cut it back to not create quite as much controversy as we've already created.

THE COURT: All right. Very good.

MR. GALARDI: So, again, Your Honor, with respect to that we think it's sufficient to raise the objection, sign a pleading under Rule 11 that says that we have these claims just like I would sign a complaint. I don't have to verify a complaint with respect to a preference action. A lawyer can assign it. We've -- we understand Rule 11. We're put forth our prima facie claim. Until it's resolved that puts it in temporary suspension. That's all that means until such time as that's resolved and those claims should be held temporarily disallowed or whether you want to call it temporarily semi-allowed or suspension or abeyance, that's what Katchen v. Landy says and we think that that's still the law.

THE COURT: All right. Thank you.

MR. GALARDI: Thank you.

THE COURT: All right. Why don't we take a -- about

15 minute recess and then I'll hear everybody else's response?

COURT CLERK: All rise. Court is at recess.

(Recess)

COURT CLERK: All rise. The Court is now in session. Please be seated and come to order.

THE COURT: All right. I will hear arguments opposed to the debtor's position. Mr. Stern.

MR. STERN: Good afternoon, Your Honor. David Stern, Klee, Tuchin, Bogdanoff & Stern appearing on behalf of paramount Home Entertainment. I'm going to try to be brief and not go over the areas in the brief.

There is one area of confusion however. The original objection that was filed took three different points. One was that 502(d) applied to 503(b)(9). That's teed up. Second was that there should be temporary disallowance by virtue of the association of the 502(d) preference. That does not appear to be any more teed up. It appears that was withdrawn in a reply that there is not a request for currently temporary disallowance. If I've misread that then I've missed a lot.

But that was how I read the reply that just came in, I believe it was either yesterday or the day before. The final thing was an argument over whether or not the new value exception to the preference liability could be utilized by somebody who has a 503(b)(9) claim. I don't know how that exactly comes in but I do think it is gloriously premature to

deal with that. I'm happy to do so if we are actually ruling on that. I would hope that at some point Mr. Galardi would clarify based on the reply whether or not we are dealing with all three prongs or just prong one.

THE COURT: From the Court's standpoint, the Court is looking at whether 502(d) can be applied to claims filed under 503(b).

MR. STERN: That's fine and that's how I understood it after the reply. I did not understand that as the objection. Let me just sort of --

MR. GALARDI: And that's my understanding today, Your Honor. The implications of temporary allowance we can deal with but since most people addressed it, I just addressed it. But simply the legal issue is does 502(d) apply to 503(b)(9).

THE COURT: All right. Thank you.

MR. STERN: And I appreciate that. I just want to make sure I --

THE COURT: I'm glad I got it to.

MR. STERN: Yes, I just wasn't sure. Your Honor, I think Your Honor hit on a couple of points and I want to address those directly. Mr. Galardi, you know, went on at great length about are we a creditor, do we have a claim and my answer is yes we are and of course we have a claim. But it doesn't answer the question. It only poses it.

This isn't a semantic test of how one looks at the

statute. One has to look at the statute's architecture and I think that's where Durham comes in. I think that's where Ames come in. Claims were indeed filed by proofs of claim because this Court ordered claims to be filed by proofs of claim if they were 503(b)(9) claims. 503(a) doesn't require it to be that way. It can be a request for payment as opposed to a proof of claim and again we can parse those words until we are blue in the face.

The real point here is that a 503(b)(9) claim falls into what I will term a different silo; something that Durham recognized, something that Ames recognized, which is that you have claims that fall into the proof of claim or scheduled claims context and those are subject to 502(d).

You have claims that fall into the 503 category and that's where Ames becomes significant and that's where Durham becomes significant because those claims are of a different nature. They are claims that are payable in full at the petition date and that's a very significant concept. They are also payable in full.

One of the points that you raised in your questions is, Why, Mr. Galardi, didn't you simply file this as a setoff? You have a 547 claim. You can set it off. That seems to be in fact what they are doing or asking ultimately to be done which is that there's going to be a dollar for dollar setoff under 547. The reason for that, I think, is that they just

don't have the facts, the evidence and the like to do that right now. If they do, then they ought to do it in an appropriate fashion.

I analogize this as trying to seek an attachment. However you want to look at it, you can analogize it an attachment or seeking immediate credit. They have a -- we have a, for all intents and purposes, an allowed 503(b)(9) claim. In our case $3 million. I know they reserved their objections. We understand that. But for these purposes we've got a $3 million claim.

What they are doing is they assert without any evidence or any, you know, even any detail we've got a $300,000 offset for a preference. If they were to do that in an appropriate fashion, what they would have to do is make I would say, they would probably have to prove that they have it, but even if they didn't they would have to show the probable validity of their claim and then we can get into all those marvelous issues as to whether or not new value does apply, doesn't apply, whether it was an ordinary course payment, maybe even whether it was within 90 days.

The attempt to use 502(d) is just slightly off point and I think it is off point both as a matter of statutory construction, as made clear in the Ames case and the Durham case, and as a matter of fundamental logic in the way it is being used here. For that reason I think the relief they seek

here really isn't appropriate.

I would also assert that, you know, one of the questions that was asked, you know, by Your Honor was whether or not the Durham case was problematic. It is extremely problematic for the debtor in this case. Clearly it is not on point, but it definitely advises where the Fourth Circuit stood on this issue. It stands out as circuit precedent. Your Honor can distinguish it and, you know, I've often said that you know good lawyers can practically distinguish any case that's ever been written.

THE COURT: I'm learning that.

MR. STERN: Yes. You certainly will see that in this case. But if you look at two things, you look at the weight of authority on whether or not 503(b) claims -- 502(d) can be used against 503(b), whether it is 503(b) generally or 503(b)(9). The overwhelming weight of authority and in terms of the chronology. The more recent cases say no.

You have the Ames case which is a circuit level decision and granted it is not this circuit, but you know, we don't gratuitously create inter-circuit conflicts. That's a policy in every circuit in the country. And we've got the Durham case that is of a piece with Ames.

I would assert that 502(d) should not be used as against 503(b)(9) and if, in fact, the debtor has a bonafide preference case against anybody here or anybody not here the

way to assert that -- and I'm not saying it has to be asserted by adversary or affirmative defense or offset. I really don't care what the procedural framework is, but they've got to make the prima facie case, plus they've got to show probable validity.

It's like getting an attachment. They owe us $3 million and what they are saying is we don't have to pay you $300,000 of it. We have a good claim. They don't have anything yet and until and unless they do, we shouldn't even approach this subject. I don't think 502(d) applies here. I don't think 502(d) is being used here in the way in which it is even written, as Mr. Galardi indicated.

I think they've come in the wrong door and I think the door should be closed for multiple reasons.

THE COURT: All right. Thank you.

MR. GOLDBERG: Good afternoon, Your Honor. Mike Goldberg on behalf of Samsung. Your Honor, we have a $19 million 503(b)(9) claim. The debtor's argument is intuitively at first blush, a claim is a claim is a claim and our 503(b)(9) claim is a claim according to them and therefore it shouldn't be allowed under 502(d).

THE COURT: Well the problem is just like Mr. Stern was saying is, you know, you say well we are just going to parse this language. But really, you know, what the Supreme Court says we have to apply the plain meaning. And when you

look at the plain meaning of the defined terms, you know, Mr. Galardi makes a good point and, in fact, Judge Shefferly in his opinion said, if you look at 502(d) all by itself it makes sense. The problem is, how does it fit into the overall structure?

MR. GOLDBERG: Exactly, Your Honor. When you get to the statutory construction and look at the statutes, it is clear when you read them that 501 and 502 deal with 501 the filing of claims, 502 deemed allowance in (a), objections in (b), skip over the temporary allowance of (c) and get to (d) and you have 502(b) which says shall -- “notwithstanding subsection (a) and (b), claims against individuals who received an avoidable preference shall be disallowed.”

Notwithstanding language is very important, Your Honor. It doesn’t say notwithstanding (a) and (b) and 503. It doesn’t go there. It doesn’t skip between the sections and go there. It says notwithstanding (a) and (b).

Congress easily could have put that language in there if they wanted. Another very important statutory construction. 502(d) says, “shall disallow.” 503(b) says, “shall be allowed.” You can’t make those two mandatory provisions coexist without butchering the construction of the code. To follow up on Mr. Stern, he is exactly right. 501 and 502 are separate silo from 503 and it was the intent of the code.

Now, how do I say that? Well 501 has its own filing

instructions and the allowance of 502. 503 says you can request a payment for administrative expense. Under that section it has its own filing requirements and its own filing rules. It also has its own procedure. It requires notice and a hearing which is a separate procedure set forth in 501 and 502 which is deemed allowed unless there's objections.

Your Honor, they can't jive that mandatory language of each section to indicate where 502(d) goes. More importantly they discuss that 503(b)(9) is not like other administrative claims because it is pre-petition. That's a red herring. Congress --

THE COURT: Well he makes a good argument though. I mean, we ought to talk about this because he says look a 503(b)(9) administrative expense claimant is a creditor and, you know, as defined in the bankruptcy code unlike some other types of administrative expense claimants. So it is a creditor that has a cl aim and then based on 501 it would have to file a proof of claim.

MR. GOLDBERG: I disagree with that.

THE COURT: Okay.

MR. GOLDBERG: I think it's dealt with as an admin claim under 503 and you file it as 503. I disagree with Mr. Galardi. I don't think there's anything in the code that says you have to file that under 501.

There are -- this is not the first pre-petition claim

that's afforded administrative status. It's a function of congressional intent to give special treatment to these. You have -- in fact there are nine listed admin claims in 503, three of them deal with pre-petition issues and six of them deal with post-petition issues. This is not new.

It is a function of congressional intent to elevate the treatment of these claims. Now Congress certainly if they wanted to distinguish they could have gone to 507(a)(2) and said, hey we are going to pay these post-petition admin claims first and then we are going to make (a)(2)(1) which are these pre-petition admin claims. Congress didn't do that. They treated them all the same.

It is identically treated and nothing in the statute which Your Honor is charged in applying indicates that the pre-petition claims should be treated any different, pre-petition admin claims should be treated any different than the six post-petition admin claims. There is nothing in there that states that. You know, they are asking you to do that and they are asking you to do this, but Plastech, TI Acquisitions, these have all been briefed by many of the parties, these courts very well briefed. Mr. Galardi was there in Plastech. I'm sure he put another 50 page brief in there and had his day in Court.

I'm not saying it is binding on Your Honor, but it's been considered at least by one Court that issued a pretty thorough opinion and rejected those arguments. Ames, although

it is clearly I agree with Mr. Galardi 100 percent, it said we are not reaching whether 503(b)(9) is at issue here, but they determined that it doesn't apply to admin claims. But these are, you know, as Mr. Stern said, the newer cases, the TI Acquisition cases, basically stating that Plastech and TI that 503(b)(9) claims are not subject to 502(d). They go through the statutory construction I just went through.

And the second reason and a very important reason, they go through policy reasons. Now Mr. Galardi tries to distinguish between this pre-petition dealings with the debtor versus post-petition dealings. Well, Your Honor, bankruptcies usually don't come as a surprise to most people unless it's some big fraud that it, you know, spurs on.

Creditors sort of know when companies are in trouble. If you were to apply 502(d) to 503(b)(9), you would shut companies down prematurely in that time period because creditor lawyers like myself and some of the others here would immediately tell their clients as soon as those companies start getting into any bit of trouble, stop dealing with them. You don't have that elevated 503(b)(9) claim that was trying to recognize your reclamation claim. They would say stop dealing with those companies completely.

Now Congress also, there is one part that has not been discussed, in affording this special treatment on 503(b)(9) claims Congress actually is recognizing that these 20

day deliveries, these massive deliveries within that 20 day period are actually benefitting the estate because in most likelihood they are in the hands of the debtor at the time that the debtor files bankruptcy. They are probably not sold. They are probably in the debtor's estate ready to be sold.

Congress said hey, we should give a benefit to these people who are actually basically funding that debtor's estate. And it is also based on the recognition that most debtors again going back to my point a minute earlier, they don't just go bankrupt. There's planning, there's planning with their lawyers, there's retention of counsel, financial advisors. Congress recognized that. They recognize that in that 20 day period the debtors knew they were going bankrupt probably. Not every time, but in many cases.

Congress is recognizing that the creditors who are the biggest victims of that, the people who deliver in that 20 days they could have said 30 days, they could have said 40 days, but they chose 20. And Congress is recognizing that those creditors needed this added protection.

Basically, Your Honor, the structure reasons as I am following up on Mr. Stern because I like his silo treatment. The policy decisions dictate that 502(d) does not apply to 503(b)(9).

Now, Your Honor, and I don't know if you want me to respond to the allowability argument of when 502(d) is ripe.

Now? You originally --

THE COURT: You may respond to that as well.

MR. GOLDBERG: Your Honor, the bulk of the recent cases, and I think the better recent cases do say that you actually have to have an adjudication in order for 502(d) to be applicable. Just for purposes of the record, I want to point the Court to In Re: Atlanta Computing Systems, 173 BR 858, "Section 502(d) clearly envisioned some sort of determination of claimant's liability before it's claims are disallowed in the event of an adverse determination a provision of some opportunity to turn over the property." An opportunity to turn over the property, not some sort of prejudgment writ of attachment which this is basically serving as.

In re: Leads Corp, "To disallow" -- and that's bankruptcy court Delaware 2000, 1260 BR at 684, "To disallow a claim under 502(d) requires a judicial determination that the claimant is liable." In Re: Midwest Agra Development Corp, 387 BR 580, "Because Section 502(d) provides that an entity's claim is not disallowed if the entity pays the amount owed or turns over the property, the Court may only use 502(d) to disallow a claim if the entity is first adjudicated liable under the applicable section."

THE COURT: Well, isn't Mr. Galardi though giving an opportunity to turn over the property in the way that he is applying statute by saying look we are only going to

temporarily disallow the claim to the extent that we think we have an avoidance claim? So actually you don't then have to turn over the property and then get it paid back, but actually just treating that portion of it as being temporarily disallowed.

MR. GOLDBERG: That is the most fundamental denial of my client's due process you could have, Your Honor. Because I have the right to defend a preference claim. In fact, I think the debtor is being a little cute. In their papers they say, we have done our due diligence, a thorough analysis and applied new value. What they don't tell you and most people know is that this debtor was paying its bills in the ordinary course of business right up to bankruptcy, fairly close. They say in that prima facie evidence that they even did an value analysis -- I mean that they did an ordinary course analysis or a contemporaneous exchange analysis. They just picked new value.

To get back to my due process argument for me just to -- they are giving me the opportunity to turn it over. No. Because they are not giving me the opportunity to bring somebody before this Court and present my ordinary course of business analysis, my new value analysis and my ability to challenge and to have a preference. Samsung for instance was cash in advance for much of this. Arguably I don't even have an antecedent debt transfer, or if I do I have a contemporaneous exchange. That just shows you how 502(d) -- it

proves my case on 502(d). And then the denial of due process, I should just hand it over.

Your Honor, I don't know if there is any other questions you have for me, but based on the statutory construction which clearly indicates a 502(d) is not applicable to 503(b)(9) based on policy reasons, evidenced by the statute and based on the fact of the cases. I just want to add one more case, In Re: Mountaineer Coal Company, 247 BR 633 Western District Pennsylvania 2000, Section 502(d), "would not appear to be applicable unless and until a finding under one of the cited Sections has been made and complainants fail to comply with such a ruling."

Under those reasonings I would say that Your Honor can not hold the 502(d) as applicable to 503(d), should not because it would have detrimental affects. It would have worse affects on the bankruptcy, debtors that are on the verge of bankruptcy because creditor's lawyers would have to advise all their clients to immediately cut that debtor off and would counter-serve any congressional purpose of trying to work and facilitate creditors working with debtors.

If Your Honor has any other questions otherwise, I'm through.

THE COURT: Thank you, Mr. Goldberg.

MR. GOLDBERG: Thank you, Your Honor.

THE COURT: Mr. Epps.

MR. EPPS: Good afternoon, Your Honor. Just very quickly I would like to say a couple of things.

THE COURT: Could you identify yourself on the record, Mr. Epps.

MR. EPPS: I'm sorry, Your Honor. I'm A.C. Epps, Jr., Your Honor, appearing once again for Digital Innovations.

Your Honor, it is an extremely well briefed issue. Many of these briefs in fact cost more than my client's entire claim. Nevertheless, I would like to say a couple of things that I think haven't been brought forward at least in the oral argument today.

First of all there seems to be an undercurrent of perhaps the fact that I haven't read the Ames case. That is clearly not correct. As a matter of fact, I was going to point out to the Court what the Ames case actually did say about this issue I think and recognizing it doesn't speak directly to Section 503(b)(9).

The Ames Court said and I think that it is really hard to argue with this regardless of the word by word picking apart of the Sections 501 and 502 that we've talked about before. The Court says, "Second and more importantly the bankruptcy code gives a higher priority to request for administrative expenses and a pre-petition claim in order to encourage third parties to supply goods and services on credit to the estate to the benefit of all the estate's creditors."

That integrity frustrated by allowing a debtor automatically to forestall or avoid payment of administrative expenses by alleging that a vender had been the recipient of a preferential transfer. Now admitted we know that does not apply by this Court's own words to 503(b)(9) directly, 505(b)(9), excuse me.

But there isn't any question if you look at Section 503 that the Congress has denominated this as an administrative expense. The fact that it came up pre-petition I think is interesting but I think it is a false lead. I think Mr. Goldberg quite accurately explained why it should be an administrative expense. But it's more than why it should be an administrative expense, it is an administrative expense because that's where it is in the code. I think that whatever else one thinks about Ames, I think this Court got that exactly, directly. I ask the Court to think long and hard before it disregards that.

Once again, I would like also to reiterate my discussions about the practical effect of what the debtor is asking for in this case. The practical effect of what the debtor is asking for in this case is that administrative expense obligations can be continued for years without payment based on preferential allegations -- allegations of preferential liability. That, I submit to the Court, is a complete change of the code's idea of who should have leverage

and under what circumstances. Because if there is no agreement, these cases can be tried in 2012 rather easily. It could be 2013, you never know.

But these administrative expense claims, if the Court finds that that is exactly what they are under 503(b)(9), should not be subjected to that. Thank you, Your Honor.

THE COURT: Thank you, Mr. Epps.

MR. CARRIGAN: Your Honor, I'd like to focus on -- David Carrigan for Bethesda Softworks. We'd like to focus on our claim, the Bethesda Softworks claim and how it fits into the context of the arguments that have been made about 502(d).

At the outset, we have in round numbers now $3.8 million in a 503(b)(9) claim. That is supported by a sworn proof of claim form that was directed by the Court and provides all the information. It's been the subject of two other omnibus objections and the substance of that claim has not be challenged in any way, shape or form other than through this 51st omnibus objection.

There is also another claim on a separate form which has also been the subject of two omnibus objections for $34,000 which, until we became aware recently that the debtor asserts a setoff claim for accounts receivable is either a secured claim or it's an unsecured claim in whole or in part. But leaving that aside, we have 503(b)(9) of approximately $3.8 million.

In analyzing the amount that the debtor proposes to

temporarily disallow as an avoidable transfer under -- and to temporary disallow under I guess it's 502(d), the debtors have indicated I believe in their papers that they have not taken into account as new value -- they have done the new value analysis, but they have not taken into account in that new value analysis any transfer that gave rise to any part of the 503(b)(9) claim.

Now what that means by -- and they've come up with this number of $100,000 by excluding all value attributable to transfers that are part of the 503(b)(9) claim. They have come up with a number that should be temporarily disallowed of approximately $100,000.

What that would suggest is, more than suggest, what it means is that in -- let me just step back for a second. The debtors didn't file any affidavits. They filed nothing other than the naked allegation that that's how much it is, not taking in account the 503(b)(9) transfers. They've also said that this is a proof of claim exercise and that we are claimants and that we are subject to the rules on claims, and that we should know, that we should even after the Court's order we should have filed a proof of claim form for this.

The official form of course has a list of administrative claims that need to be filed. The official form doesn't have 503(b)(9) on it. What does have it is the form, special form that was approved by the Court. If we want to go

down that road we can go even farther. The schedules and statements of affairs don't have a schedule of priority claims under 503(b)(9). They have a bunch of other scheduled priority claims, but they don't have a schedule for 503(b)(9) claims. So the debtor doesn't disclose up front what they are.

If this whole proof of claim business and this literal interpretation of the pieces of the puzzle is supposed to follow, shouldn't there be a schedule of 503(b)(9) claims that the debtor would have to file if he followed through? To follow up on that particular point, 507(a) says, (a)(2) says, "The following expenses and claims have priority in the following order. Two, second, administrative expenses allowed under 503(b) of this title and any fees and charges assessed against the estate under Chapter 123 of Title 28." Nothing about anything being allowed under 501 or 502. It's a separate -- as Mr. Stern said, it's a separate silo. It doesn't fall into that particular piece of the puzzle.

But back to the debtor's analysis. So we have an affidavit in fact in effect, two of them actually, both proofs of claim on the part of the creditor. We have no affidavits. We have no exhibits except the summary conclusion as to what the -- what the amount of the 503(b)(9) claim would be except that absent the amount that they believed could be avoided under 547(b) and they exclude from that analysis any new value that may be attributable to transfers under the 503(b)(9)

claim.

Well, what does 547(c)(4) say? 547(c)(4) says that the trustee may not avoid, under deception, a transfer to or for the benefit of a creditor to the extent that after such transfer such creditor gave new value to or for the benefit of the debtor. And (b) says on account of which new value, the debtor did not make any otherwise unavoidable transfer to or for the benefit of such creditor.

So if you take them at their allegations that they have applied all the new value that is available except for the new value attributable to the 503(b)(9) claims, what that would say is that we have roughly $3.7 million of new value to be applied against $98,000 that might otherwise be avoidable under 547(b), which means that we have no preference liability whatsoever by their own figures.

So 502(d), even if it does apply to administrative expenses, doesn't apply to our administrative expenses. For that reason, and if we go back to the where we are procedurally in this process, they've essentially filed a motion for partial summary judgment against us and against everybody else in the room I suppose.

They did not file any affidavits or any supporting materials. They've just made the bare allegations and they've caveated those bare allegations by confining their use of new value to one segment of the available new value.

Under rule 56(e)(2) they are not allowed to seek summary judgment and get summary judgment over ours, our response, if our response is supported by affidavits and ours has been supported by affidavits from day one. Secondly, if this really is a proof of claim situation and if all the rules on proof of claim apply, then bankruptcy rule 3001(f) applies which means that our claim is presumptively allowed. Even under the cases that say that the burden shifts when an objection is made, no affidavits, no documentation, no testimony, no depositions, no support does not overtake a sworn affidavit or a sworn proof of claim form.

There's got to be something more than that. So, what we respectfully submit is that our 503(b)(9) claim is an allowed 503(b)(9) claim. It is allowed right now. Now we are willing, just as they are willing to sort of mitigate their relief that they are requesting to say well we are only going to have this little bit temporarily allowed, disallowed, but the rest of it is going to be disputed and therefore not eligible for distribution and presumably not eligible to be counted as something that has to be paid on the date of confirmation.

We are willing to say that if they really think that this $98,000 preference is out there and that there is $2,000 of offsets out there, well fine. But allow the rest of it and pay the rest of it and pay the rest of it on the initial

distribution date. And we respectfully suggest that based on the factual record that is before this Court at this moment and if the Court treats this as a motion for summary judgment or if the Court treats this under bankruptcy rule 3001(f) that our client is entitled to that treatment at the least.

But the key thing is that go back to 502(d), even the language of 502(d). When does 502(d) disallow a claim? It disallows it when its -- when the creditor is subject to a recoverable transfer. Well if new value -- if the transfer constitutes new value and eliminates -- if there is new value and it eliminates the liability or precludes, actually doesn't eliminate it, it precludes liability for preference because they say the trustee may not avoid these kinds of transfers.

We have the new value by their own admission. It's subsequent to the last payment. It has to be given the framework that they've set up. That $3.8 million since it can't be avoided, it can't be recovered under 550. Since it can't be recovered, it's not subject to 502(d). That's -- the other fallacy in this exercise is if 502(d) does apply, what happens if we turned around right now and paid it back to the debtor? Then we would be allowed. The whole amount of the 503(b)(9) would be allowed and would be eligibly paid.

This is a 100 percent plan as to 503(b)(9) creditor claims supposedly. If it is, this whole exercise is an exercise that just postpones payment. It doesn't address the

validity of the claim or anything else. Application of 502(d) to 100 percent claims really makes no sense at all. None. Because it's just a circular exercise.

Mr. Galardi was talking before about, well we do this and we do that and why should we do all this stuff. Exactly. Why should we do all this stuff when at the end of the day 100 percent of the 503(b)(9) claim has to be paid? And there is no preference because of the application in new value.

Respectfully, Your Honor, two things, at least as to the folks in my client's position, deny the motion. Secondly, allow the claim for purposes of the confirmation hearing and for purposes of distribution. If the Court has misgivings about allowing the claim in the full amount, then take out the pieces the debtors want taken out and put it aside, but adequately protect that amount. Treat it as an attachment. Make them put the money aside or otherwise escrow for it in a way that it will be there because at the end of the day some amount of that money is going to be due to us even if the setoffs of the ARs are appropriate.

For that reason, Your Honor, we'd ask two things. One is deny the motion at least as to us and, two, grant our relief which is to allow that claim for purposes of the three purposes again for allowance of claim, voting doesn't matter. We don't get to vote. It's allowed for purposes of distribution. The first distribution date is supposed to be a

few days after it. It means something to companies to get paid this year as I'm sure it meant to the settlement -- the folks that were parties to that settlement as opposed to getting paid next year. It means something because the next distribution date isn't going to be some time until next spring.

We are going to wait three or four months or something for it, at least. And if not, if we miss that one, we are on for three or four months beyond that. So it means something and it also means something in terms of evaluating whether this plan is ripe for being confirmed because the requirement is that they pay all allowed claims on the date of the filing.

If this exercise is about saying we don't have enough money on the confirmation date to pay all of the administrative claims then the debtor and the other proponents of the committee, the committee ought to be forthright enough to stand up and say that that's what the problem is. You know, if they were to say to us, look we've got to postpone some of these payments, well we can always agree to do that. That's something that the administrative creditors can do.

But that's something that ought to be in the plan and we ought to have the right to say whether or not it happen to us or not happen to us through the backdoor like this. If the Court has any questions, I am happy to try to respond.

THE COURT: Thank you, Mr. Carrigan.

MR. CARRIGAN: Thank you, Your Honor.

MR. AUERBACH: Good afternoon, Your Honor.

THE COURT: Good afternoon.

MR. AUERBACH: Dennis Auerbach, Covington & Burling LLP, on behalf of Apex Digital and THQ Inc. Your Honor, my application for admission pro hac vice is pending before the Court. My colleague, Mr. McCartcher, who was admitted in this Court is in the courtroom with me today.

THE COURT: You may proceed. Welcome to the Court.

MR. AUERBACH: Thank you, Your Honor. Your Honor, I will be very brief because I do agree heartily with the arguments that have been presented already by the other claimants.

I do want to address just a couple of points. Your Honor, first I believe the debtors focus on claim language and suggesting that the claimants are trying to distinguish between claim and expenses is really a strawman. What is really going on here, Your Honor, is the debtor is asking the Court to focus simply on the language of 502(d) which refers to any claim and is asking the Court to ignore the preface to 502(d) which specifically states, notwithstanding subsections (a) and (b) of this Section.

Your Honor, those words are very important and really establish that under the plain meaning rule the attempt to disallow the 503(b)(9) claims is improper and, in fact, this is

exactly what the Ames Court held. The Ames Court said, "The plain language thus introduces Section 502(d) as an exception to the automatic allowance of proofs of claim under Sections 502(a) and 502(b) and suggests that the subsection scope is limited to that process and does not extend to claims allowable under Section 503.

The notwithstanding word which is an integral part of the statute establishes that 502(b) is an exception to the allowance of claims under Section 502. Your Honor, I think this ties in very closely to the issue of whether 503(b)(9) is somehow a distinct animal, distinct from other 503(b) claims.

In fact, the way 502 and 503(b) work is, I think, quite interesting. Certain post-petition claims that would otherwise be administrative are put into the Section 502 basket and that is true, for example, of Section 502(f) and 502(g) and the code in those sections provides well, and Section 502(f) claim it shall be allowed pursuant to Sections 502(a) or 502(b) or disallowed under Section 502(d).

The same language is used in Section 502(h). So what is going on is there is certain post-petition claims that are put into the 502 basket. They are specifically subject to disallowance under 502. Correlatively there are certain pre-petition debts that are put into the Section 503 basket. And interestingly, there is no reference in Section 503 to disallow what is under Section 502.

So the plain language of Section 502(d) itself and then the structure of Sections 502 and 503 working together I think make it very clear that Section 503(b)(9) administrative expenses are not subject to disallowance under Section 502(d). Thank you, Your Honor.

THE COURT: Thank you, sir.

MS. MORRISON: Your Honor, Valerie Morrison for Envision Peripherals and LG Electronics. I want to focus mostly on the adjudication requirement that is set forth in Section 502(d). Again focusing on the plain language of the statute which says, “Claims are to be disallowed unless such entity or transferee has paid the amount or turned over such property for which such entity or transfer he is liable under the avoidance sections including Section 550.”

Disallowance is limited to cases, Your Honor, where the transferee has failed to pay the amount for which it is liable. That is set forth. And the enumerated provision applicable to our situation with preferential transfers is Section 550. It’s fundamental, Your Honor, a party can not fail to pay an amount for which it is liable until there has been an adjudication of that liability.

It is also fundamental, Your Honor, that one does not incur liability on a preference until adjudication. Section 550 of the code which is one of the reference subsections in Section 502(d) supports this reading. It says, “To the extent

that a transfer is avoided, is avoided under Section 547, the Trustee may either recover the property transfer or the value of that property."

So Section 550 which the transferee has to be liable under isn't even triggered until the transfer is avoided. That's the way the statute operates. Your Honor, transfer is not avoided by performing an analysis even a thorough analysis. It's not avoided by filing complaint or stating a prima facie claim which I would argue hasn't been done here at least with regard to the prima facie. We know a complaint has not been filed. But it is only avoided by a judicial determination of liability.

Your Honor, Section 502(d) in my view strikes a balance between the bankruptcy codes very sound policy of promoting equality of distribution on the one hand, and a preference litigant's fundamental right to a day in court before being deprived of its property.

The property we are talking about here is an imminent right to payment and administrative expense. In the case of both of my clients their 503(b)(9) claims have been fixed by prior order of this Court. They are set. They are, if not allowed, they are fixed and determined. I'm not aware of any other objections that can be raised in that.

So they have a perspective right that is imminent on the effect of date of the plan to be paid. Your Honor, it is

important to note that Section 57(g) of the Bankruptcy Act which preceded Section 502(d) did not expressly condition disallowance on a party's failure to pay the amount for which it is liable. The "is liable" words are new. They are new to Section 502(d) and Congress put them in there for a reason.

The debtors say they did an analysis of the preferential transfers and one of the defenses. But by their own admission they didn't address the other defenses which could completely wipe out and erase any preferential liability for my clients and many of the others that are in this room, especially if it is correct that the debtor was paying its obligations in the ordinary course of business.

Your Honor, the reliance by Mr. Galardi on the Katchen v. Landy case is simply mistaken because it was an act case. And again the words is liable were not in Section 57(g) which is what the Katchen v. Landy case was construing. And suspension, disobeyance concept, that's not an option for the Court because Section 502(d) says the Court shall disallow. Section 502(d) does not offer other options to the Court. If disallowance doesn't apply then the section doesn't apply. There is no other relief envisioned by Section 502(d).

Counsel for Circuit City makes much of the use of the word entity in Section 502(d). The statute says that the claim of any entity from which property is recoverable is to be disallowed and the debtors argue that Congress must have

intended this to encompass administrative expenses because if they used the word creditor it would have just been pre-petition claims.

But, Your Honor, the word creditor would have actually missed something far more important than administrative claims. It would have missed the targets that are the very focus of this statute. Those parties that have received avoidable transfers or otherwise are obligated to return property to the estate like a trustee -- like a custodian or someone else who is holding property for the estate that is obligated to turn it over under Section 542, those characters are not necessarily creditors.

They may have no relationship whatsoever to the estate as a creditor, as a holder of a claim. However they are liable to the estate and when they turn that property over they will be afforded a claim. But until that point they are not a creditor, they are not the holder of a claim until they turn it over. Therefore, the word entity, Your Honor, I would submit was used to capture the host of characters that are targets of avoidance actions that may become creditors, but only if they turn over the property or pay the amounts for which they are determined to be liable.

THE COURT: Doesn’t that prove too much. I mean because they wouldn’t have a claim against the estate in that case. They can only have a claim against the estate if they

were a creditor and that's why Congress was using the word entity. It really did mean to make sure that it encompassed more than just that. When people have claims against the estates who are not creditors.

MS. MORRISON: Yes, that's the crux of my argument. But I think the focus was on the recipients of these transfers under 542, 543, 547. They are not creditors perhaps at the time of the avoidance action but they become creditors after the avoidance is adjudicated. At that point Congress says unless you pay the amount for which you are liable, your claim will be disallowed.

So they don't fit in the definition of creditor because their claims really arise post-petition. They don't have a claim perhaps until the avoidance is adjudicated. Because the statute is really focusing on those types of transactions and trying to bring them back into the estate, I think the use of the word entity was used to capture those people, those characters, and not necessarily to import the concept of administrative claim where it is not referenced anywhere in all of Section 502(d) or anywhere else in Section 502.

Your Honor, I want to address one other argument of Mr. Galardi which was that a proof of claim is required to be filed by a Section 503(b)(9) creditor. In part Mr. Galardi relies on the form, the proof of claim official form. I would

submit, Your Honor, that truly exalts form over substance because the statute Section 503(a) delineates how an administrative expense is allowed and it doesn't mention filing a proof of claim at all. It mentions filing a request for payment.

And 503(b)(9) claims are within the ambit of the 503(b)(9) allowance process. It's an entirely separate allowance process than the 501 process. I don't think you can use an official form to import a requirement that is not within the bankruptcy code itself when the bankruptcy code is pretty clear on how those entities, those expense claimants are supposed to prosecute their claim.

Your Honor, I didn't reiterate the arguments that the people that went before me made. I thought they were very well made and I would adopt them.

THE COURT: All right. Thank you, Ms. Morrison.

MS. MORRISON: Thank you.

THE COURT: Any other party wish to be heard? Is there any party on the phone who wishes to be heard?

MR. HAZEN: Your Honor, this is Scott Hazen from Otterbourg, Steindler in New York on behalf of the JVC Companies and we would request that opportunity for a brief moment.

THE COURT: Mr. Hazen, you may proceed.

MR. HAZEN: Thank you, Your Honor. I'm not going to

repeat that some have the arguments in opposition to the debtor's relief. JVC is in the 51st omnibus. It has two 502(b)(9) claims and it has asserted against those claims two alleged preferences. I adopt all the arguments on the separate silos, 501 and 2 versus 503 and among other arguments the 502(d) requirement to some determination before it could even arguably be used.

The only reason I speak up is I am only a bit concerned about what is the relief being sought today as the result of the reply of the debtors and the colloquy that occurred at the very beginning of this afternoon's, if I may call it the 503(b)(9) argument, the afternoon's argument, when it was noted that the temporary disallowance is not being sought today. That we filed a joinder and a response to the pleadings of the debtor and currently confused if Your Honor were to grant the debtor's relief, which we submit you should not, what are the consequences or what is going to follow if temporary disallowance is not what is being sought today?

THE COURT: You are asking the Court that question?

MR. HAZEN: I'm asking the -- I'm raising it as an issue. Mr. Galardi, I would appreciate if and if I had realized this before the hearing I would have called him and I'm confident he would have given the answer. But I'm confused and would hope somewhere during the course of Your Honor's resolution of the issue there will be clarity on what actually

is the relief being sought today because I do not see that clarity and thus the reason I raise the question.

THE COURT: All right. I will give Mr. Galardi an opportunity to respond, but the Court has afforded the question whether or not the debtor can use Section 502(d) in application to Section 503(b). I think that that's asked the question that the Court is under the impression that it is being asked and answered today.

MR. HAZEN: And I understand that and I won't say any more. I'm sure Mr. Galardi will clarify the specific relief when he has a moment. Thank you, Your Honor.

THE COURT: Thank you, Mr. Hazen. Any other party on the phone wish to be heard? All right. Mr. Galardi.

MR. GALARDI: Since I have a limited short term memory, I will go with Mr. Hazen's question first. Your Honor, I think you're ruling on the legal issue. I think everybody has raised issues of whether temporary disallowance is valid or not. Valid absent an order on liability. So I leave that issue open and we have to come back to the Court and have to prevail on we think -- we do think temporary allowance is appropriate, but they are free to make that argument even though some people have raised it today. They are free to make that argument if we go to seek temporary disallowance. And if that's in the context of a confirmation hearing and distributions I assume it will come up very soon.

But I'm not having a consequence today nor do I take your ruling to say I've won on the temporary disallowance. Does that help you, Mr. Hazen?

MR. HAZEN: Yes, Mr. Galardi.

MR. GALARDI: Your Honor, I'm just going to sort of do things a little bit, some small points and then I want to go to this silo approach. First, it's been raised that 502(d) has this and I know this is sort of for future but I don't want to hide anything from anyone. 502(d) does refer to 550 but what seems to be ignored is it also replies to 547 which says maybe disallowed. It doesn't have to say is disallowed. So I just want to point that out.

If it were -- and 550 says if it is avoided under 547 that is how you get it back under 550. But 502(d) refers to 547, 548 et cetera. So when I go to that temporary disallowance argument, people should be on notice that my view is, as I've said in our papers, it should be temporary disallowed merely with the objection. Just wanted to make that point.

The other point I want to make is about the gentleman, and again I know this is not today because it's not an evidentiary hearing and that's why there is no affidavit on a legal issue, but let's just be clear what 3001(f) actually says because people seem to throw these things out and not read the words.

It says the evidentiary effect. First of all this is with respect to a pre-petition unsecured claim. It's not with respect to an administrative status and it doesn't go to whether you are entitled to administrative status. All it says is a proof of claim executed and filed in accordance with this shall be prima facie evidence of the validity and amount. It doesn't go to the priority or the status even if this was to be bound by it. And we don't dispute. He's got prima facie validity that we will have to respond, but that doesn't mean just because you have an affidavit which is hearsay unless there is witnesses here, that he then gets the allowed claim today.

And as I mentioned before we can assert offset rights. So I want to touch that point. The next point I want to touch on, Your Honor, is just simply one of the points you raised to me and the more I thought about it, the more I came up with answers. So I will give you another answer.

Why didn't we proceed under 558? No good deed goes unpunished, Your Honor. I should have moved to disallow everybody's claim in full under my 502(d) objection. Maybe I should have done that. But 558 says the following. It says the debtor's defenses are preserved.

Now I haven't done the research but I'm sure I would have had the following objections. If I tried to use a 547 defense under 548, there will be people in this Court that will

say that's not what 558 intended, you have to go under 547 because 547 and 548 are all bankruptcy created causes of action. 558, if everybody wants to give me that one, I will certainly use it the next time I'm in Court. But I don't think that's what they intended there.

THE COURT: That answers the Court's question. I understand completely.

MR. GALARDI: So I don't see why 558 allows me to bring in 547 because it's a bankruptcy cause of action. That's ordinary course cause of action at least as I've read 558 and why I went through setoff. So it finally dawned on me -- not that it dawned on me not to use it in the first place. I never thought of it until Your Honor asked me the question.

Now let's go back to 502(e) and 502(f) comments. I just, again the bankruptcy code is an odd thing, but I do like to read it occasionally. I agree that 502(f) is a post-petition claim but it's a very unique -- it's that gap claim. 502(e) is not a post-petition claim. Unless this is a friendville (phonetic) jurisdiction which I know it is not, I would argue that any of these claims for reimbursement and reimbursement or contributions are pre-petition claims. They just become actual physical value claims. This becomes the liquidated claim post-bankruptcy. But that doesn't mean it's a post-petition claim.

I know people keep throwing this out but 502(e) says

the Court shall disallow a claim for reimbursement or contribution against the estate but it's when it is contingent at the time of allowance. It's still a pre-petition claim. It's just it's a contingent claim. The whole point of that section is when it becomes fixed or amount or contingent, you can do various things. But usually those are pre-petition type claims. So I don't use it.

Yes, 502(f) is an involuntary gap claim and it makes sense that it's here because there is always the dispute of when's the petition date versus the order for relief. And the code often treats those gap claims as separate.

So now I really want to go to the big issue. They say 502 is a silo and 503 is a silo. I don't say it is. Okay. They give you Plastech. They give you Ames. I disagree with it. I think the fact of the matter is it would be nice if it were silos. The problem is the involuntary creditor claim in 502(b), the claim of 503(b)(9) are creditor claims.

They've put the rabbit in the hat by saying these are silos. They are not silos. If they are claims of creditors they are governed by 501, 502. Period, end of story, that's what the statute says. That's what 3001 says. And just because they now can get elevated to a separate status, it doesn't say they are not claims. It doesn't say there are not proofs of claims required. It doesn't say they don't have to file proofs of claim and go on 501 and 502.

What it says is you've got to do that. But if you want some --

THE COURT: Where does it say that they have to do it? Because a number of people have stood up and said no we don't have to do that, we disagree.

MR. GALARDI: Okay. Well here it is.

THE COURT: Because in looking at Rule 3002, it says that an unsecured creditor must file a proof of claim. You know, and --

MR. GALARDI: Let's take that. Let's just take an unsecured creditor. 503(b)(9) is not a secured claim. It's an unsecured creditor. So why are they getting out of that? Are they a creditor? Yes. Do they have a claim? And by the way 3001 says secured creditors have to file it. It's creditors. That's the key language. Look at 5001, 501. A creditor may file a proof of claim. (b) if a creditor does not file such a -- file a proof of claim, an entity that is liable with the creditor, with the debtor. Okay, so it's drafted, who is going to file a proof of claim, a creditor.

I go back to 100 -- I got back to 101(10). What's a creditor? I want to know. I'm reading the bankruptcy code. I'm from Mars. I say, okay a creditor has got to file a claim. Okay, let me look up the word creditor. Creditor, ah here it is. An entity that has a claim that arose at the time of or before the order for relief. So my claim just have come --

it's not just that I had a claim. It had to come before the petition date.

Okay, the order for relief I know enough about the bankruptcy code that that's entered when you file a petition. So it had to be something in there. That tells me who has to file a claim. Now I go to 3001 and I say, well do I really have to do that? I really do have to do it. Then I go to 3003 actually and I look and I say, who must file claims? Oh there's a rule on this. It says who must file a claim.

Any creditor, again that word, who has a claim -- whose claim or interest is not scheduled or schedule is disputed, contingent, unliquidated shall file a proof of claim. They must file the claim. So if they are not scheduled or they are scheduled as disputed, contingent or unliquidated, they must file a claim. Why? Because they are a creditor and because it says they must in the rule and it says they are entitled to under 501.

Why do they get out of this? They are a creditor. Their claim arose prior to the commencement of the case. I don't see how they get out of it. That's what the straight language of the code says. But once you have that, then the question is well how do you reconcile 502 and 503?

It seems to me pretty simple what Congress said. If you are a creditor, you go under 502. There are certain people in 503 that are clearly creditors that have to file claims, but

they get exalted status as I say. If you want not just to file a proof of claim and be an unsecured creditor, but you want to get this administrative status, what do you got to do? You got to ask for it.

You got to make the request for administrative expense. That's what 503 says. Why don't all the other administrative creditors have to do it? Because they are not creditors. Administrative claimants are not creditors if they didn't have a claim that arose prior to the petition date.

So these unique set of creditors have the extra burden. That's all 503(b) says. It says, look you can have a priority -- you can get a claim. If you are pre-petition creditor and you want administrative status because you fall in 503(b)(9) or you fall in whatever those other sections, a tax claim or you are professional for a creditor who commenced an involuntary, you better do something else if you want a 503(b)(9).

It doesn't say notwithstanding that you never have to file a proof of claim. It says if you want this status, file the claim. But by the way if you are an ordinary course expense that arises after a debt, a liability that arises after the petition date, you don't have to do this. Why not? Because you are not a creditor.

Indeed, if you look at the bankruptcy code on classification of claims for proofs of claim, you don't

classify administrative expenses. Why not? Because they are not a class of claims. They are not a class of creditors. But that is not what it says with respect to 507(a)(2) and (a)(3) and that's the interesting thing. The bankruptcy code actually is consistent on these points and there is nothing that says if you filed under 502, don't file under 503; or if you filed under 503, you don't have to file under 502. It doesn't say that at all. It relies on the word creditor.

Now let's go to the other argument. So I don't see the two silos and somebody can explain to me why the code doesn't say you don't have to do both. I see the code through its definition saying, yes, some people have to do both, creditors. That word is clear. No one can argue that 503(b)(9) people aren't creditors. No one can argue that they are not unsecured creditors and therefore they are bound.

So now we go to the (a) and (b). Well I think (a) and (b) is pretty easily reconciled. It's the key to Ames perhaps, but I don't again understand why it is a problem. 502(d) says the following, notwithstanding (a) and (b). That is you don't get automatic allowance and if people object, whether or not they -- so (a) says you are deemed allowed, okay? Okay. Fine, so we know that if you have a potential preference you are not deemed allowed, that's it.

(b) says except under blah, blah, blah, if such objection is made, you shall be allowed, except to the extent.

So again you would be allowed under either of these provisions if you filed a claim and there was no objection or you filed a claim and there was an objection unless you fit into these categories. That's all that says, but if you file the claim and you are subject to a 50 -- you know, a 543, a 550, a 547, a strong arm, any of these things, your claim is not allowed, notwithstanding the fact that it is a pre-petition, unsecured claim that is prima facie valid until it is objected to.

This says it doesn't matter that all that happened. If you are the recipient of this, though shall not allow. Now why is that not inconsistent with 503? Because you don't have a 503 allowance until you make the request and the Court allows it. So these two mandatory provisions are not. This says it is not allowed and if somebody comes in and says, but I have this claim, I want the exalted status, I want an administrative, I want to get granted administrative status, you've got to give it to me if it's 503(b). Yes, we have to give it to you if it's a 503(b) and it's a claim that's allowed. But if it's not allowed, I never have to get to the issue of whether it's mandatorily allowed.

Because you didn't pass step one, you didn't get the claim allowed in the first place. But once you are allowed in your 503(b), I agree with you. So I don't think these -- clashes of mandatory provisions are at all inconsistent with the code. I'm not asking you to read two provisions

inconsistent.

The question is where do you go first if you are a creditor? You go to 501, 502. Once you pass go, then you can ask for certain status, just like people can ask for priority status. And if you ask for the status and you get administrative status, you get the treatment, but you've got to pass go. You don't just jump to the administrative expense.

So in that understanding, Your Honor, not the two silos, nothing in the code says that there are two silos that they can't be both. The fact of the matter is they are subject to 502(d).

Let me see if there was anything else. Your Honor, I didn't rely on the form for the fact, but I do find it again, my code is my creditor definition. But it is interesting that the interesting fun fact, perhaps, that it says the form should not be used to make a claim for administrative expense arising after the commencement of the case. A request for payment of the administrative expense may be made under 503. It doesn't preclude you from using this form for pre-petition claims.

Now I don't know if that's just dumb luck or it's a fact that somebody actually thought about because I don't think anybody in Congress ever thought about 503(b). Your Honor, again, we will have an evidentiary hearing but I can't believe the venders in this courtroom are saying well because we knew we'd get administrative status, we continue to get credit.

That's just not true. They've been arguing about administrative insolvency and concerns from the very first day.

We wouldn't have had those arguments. We might not even have the liquidation that we had if they weren't so worried about these 503(b)(9) administrative claims. So they didn't ship, again, they are not using evidence. I'll take my shot. They didn't ship because they said oh, well I'm safe because I'm going to have an administrative claim because everybody knows Circuit City is going to bankruptcy. That's just hogwash.

I have nothing further, Your Honor.

THE COURT: All right. Thank you, Mr. Galardi. All right. Once again, this was very well briefed and I thank everybody for the excellent presentations that have been made on the matter. The Court has heard quite a bit today by way of the arguments and the Court would like to go back and look at a couple of these cases once again in light of the arguments that I have heard today. So I'm not going to make a ruling from the bench, but I will take this matter under advisement and I will be issuing a ruling very shortly.

So with that, do we have anything further that we need to take up today, Mr. Galardi, on the docket for Circuit City?

MR. GALARDI: It's not on the docket but since everybody has asked and I know Mr. Pomerantz is on the phone.

We are not going to be proceeding with confirmation on November 23rd, but would like to move that and adjourn it to December 21st keeping the objection deadline. I believe it's the 16th, the same.

Your Honor, just to give by way of -- it has really nothing to do with the administrative cost. As Your Honor knows we closed a sale in Canada a while back and there are proceeds that are coming back from Canada to take full advantage of -- well let me put it this way. To avoid -- well I won't say it that way either.

To get the maximum recovery by way of dividend and ex-repatriation of the funds, it is important that we first do certain corporate matters with respect to debtors to make sure that the money flows and we get the maximum value back. That requires that we do those things prior to confirmation and forming a liquidating trust. So consequently that is why we are going to ask to -- we are going to -- we would like to adjourn the confirmation hearing from November 23rd. I think Your Honor has a December 21st calendar date that we are already on for an omnibus date. That would be our intention to proceed at that point if we could get these corporate matters resolved.

I think Mr. Pomerantz is on the phone. I don't know if he wants to add to that comment.

THE COURT: Well before I turn to Mr. Pomerantz, is

there any expectation that the confirmation hearing would have to take more than one day?

MR. GALARDI: No. Well, again, Your Honor, it depends on what the evidentiary burdens of the people are on feasibility with all of the administrative claims. That would be the only thing that I think could take on more than a day. But I think, Your Honor, at this time to schedule that because whether we can accomplish all of the corporate amalgamations and actions by December 21st is still an issue.

What I'd like to do is just plan for a day and then sort of give Your Honor an update. I think we are also here on December 7th. To give Your Honor an update on December 7th as to where we stand so that we don't fly people in for that purpose. But to try to keep it posted with every omnibus hearing as to where those stand. Again, it's a corporate matter. It just may take more time and a revenue ruling from the Canadian government.

THE COURT: All right. Very good. Mr. Pomerantz, do you wish to be heard on that?

MR. POMERANTZ: Yes. Briefly, Your Honor. The committee supports the continuance. We are hoping to resolve the corporate issues that Mr. Galardi mentioned. And I agree we will have a little better information a few weeks from now and can advise the Court of our progress at the December 7th hearing.

THE COURT: All right. Thank you, Mr. Pomerantz. Mr. Carrigan, do you wish to be heard?

MR. CARRIGAN: Just one point, Your Honor. Since the Court is taking part (b) of today's hearing under advisement, I thought I heard Mr. Galardi say that they weren't contemplating the extended objection date with respect to the adjourned confirmation hearing.

In light -- What the Court decides may very well affect what kind of objection and the nature of objection people in the 503(b)(9) group may have on this. What we would ask is at least for the -- for my client, if not all the 503(b)(9) folks that they get a little extra time once we've seen the Court's ruling to evaluate how it fits into an objection to the plan.

THE COURT: Well, I mean, you could always file an objection and withdraw it if you saw what the Court ultimately ruled on the matter, could you not?

MR. CARRIGAN: I could also spend my client's money doing that when I might not have to do it.

THE COURT: All right. The -- let me hear from Mr. Galardi on that.

MR. GALARDI: Your Honor, excuse me, as I mentioned at the outset, I think the issue has been out there and the plan confirmation order and the plan itself with the disputed claims and the objection deadline. So I'm not sure what an

extension does. I don't want to put anybody -- to the client's money but I would assume that all of these issues would have been ripe for their objection already because our analysis even on 503(b)(9)s is there is a 503(b)(9) objection deadline and they wouldn't be receiving a distribution and that's all set out in the plan.

If they have a problem with that provision, I'd rather see now what that objection is and I think I take it the following, they will be objecting to that provision and that will give me that much longer to try to resolve any objection before December 21st. So I prefer to see those objections now without Your Honor's ruling, and maybe Your Honor's ruling may affect settlement sort of negotiations. But the legal issue of disputed claims has already been out there and been out there for quite a period of time.

THE COURT: All right. Thank you. all right, the Court will grant the continuance of the confirmation hearing to December 21 and that subject to status conference on the 7th to see if we are actually going to go forward on that day so that if we are not everybody does not have to fly in for a confirmation hearing that may not be taking place.

As far as the claim objection deadline is concerned, the Court is not going to unilaterally extend that. If any particular creditor feels aggrieved, they can certainly file a separate motion with the Court asking for an extension of time

or take that up on a case by case basis or if it can't we worked out consensually between the debtor and the creditor.

Any other business we need to take up today, Mr. Galardi?

MR. GALARDI: Nothing by me, Your Honor.

THE COURT: Okay. We've got separate hearings in LandAmerica this afternoon, so I'm going to take a recess so we can get those parties on the phone before we go into the next matter. So we will take about a 15 minute recess.

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C E R T I F I C A T I O N

We, Mary Polito, Rita Bergen, Amy Rentner and Lynn Schmitz, court approved transcribers, certify that the foregoing is a correct transcript from the official electronic sound recording of the proceedings in the above-entitled matter, and to the best of our ability.

/s/ Mary Polito DATE: November 18, 2009

MARY POLITO

/s/ Rita Bergen

RITA BERGEN

/s/ Amy Rentner

AMY RENTNER

/s/ Lynn Schmitz

LYNN SCHMITZ

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